Impact of Foreign Capital on Indian Economy

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by

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Preface

THE problem of foreign investments in India has been an issue of outstanding importance ever since the days of the East India Company. It acquired a different complexion and added significance after Indian Independence. However, it was only after the launching of the Five Year Plans for comprehensive economic development that this problem assumed a new dimension in economic thinking.

It is generally accepted that foreign capital can register an impact on the economy of the recipient countries. But economists differ on the nature of this impact or the relative importance of the cost which the recipient countries have to incur or the benefits which they acquire. The problem of determining the exact role played by foreign investments in the economic growth of the borrowing countries has not been settled to the satisfaction of either the layman or the professional economist. Moreover, since most of the studies so far conducted on international investments reflect the point of view of the capital-exporting or donor countries, there is need for approaching the problem from the point of view of a recipient country such as India.

In the studies so far made on foreign investments in India, the focus of attention has been on the net results as seen from an analysis of net capital inflow and outflow of investment income. Other factors such as the effects of foreign investments on the volume of domestic product, income, employment, foreign trade, and balance of payments, have been left out. The role of foreign investments in the economic development of the Indian economy has not received adequate attention so far in the economic literature covered by Indian economics. Needless to state that there is an increasing need to extend our knowledge of the impact of foreign investments on the economy of our country. In the present study an attempt is made to assess the impact of foreign investments on the Indian

economy, taking into account as many variables as possible and subject to the limitations imposed by the available data.

It cannot be over-emphasised that the role of foreign investments in the economic development of a recipient country cannot be enumerated in simple and general terms. It can be ascertained in any precise form only if we make a detailed study of the impact of such investments on the indigenous economic structure of the recipient country and the costs and benefits involved in the process.

For a study on the above lines, the major obstacle, as usual, is the paucity of adequate data which go beyond the familiar estimates of book values, net capital flow and earnings of foreign investments. In the preparation of this book full use has been made of the available material on the subject. While the present study has no claim to be an encyclopedia, an attempt has been made to assemble, analyse, and interpret, as comprehensively as possible, all the relevant facts relating to the subject. The conclusions drawn from the already available observational data have been tested and corroborated, to a large extent, by information collected from field work, mainly interviews and discussions with foreign company officials and executives. The author had the opportunity to investigate closely into the working of the foreign firms, particularly in the jute-mill industry and the tea planting industry.

Any attempt to bring together in a closely-knit analytical framework all the scattered and unmanageable data on foreign investments in India is, undoubtedly, beset with difficulties. An exhaustive appraisal of the role played by international capital in India's economic development seems to be too ambitious, given the existing limitations of data. What is attempted in the present study is to provide a tentative framework which could possibly form a convenient basis for further study and research.

It is obvious that if the analysis is to have any relevance to wider problems of partnership between industrially advanced creditor-countries and the relatively less developed recipient countries, the study should seek to provide explanations for some of the major trends in international

capital movements in general. Chapter I of this book has been designed primarily with this objective in view.

The present study covers the history of foreign investments in India from the early decades of British rule to the present time. The period before Independence has been sketched in a fairly concise manner, tracing only the salient features of the historical background. What it largely concerns with are developments in the field of foreign investments in India in the post-Independence period, especially during the 1950's, the Plan decade. Chapters III to VIII seek to explain the trends in the growth of foreign investments in India, the changing pattern of international capital both from private and public sources abroad, the variations in their benefits and costs and the implications of foreign capital penetration to the growth of the national economy. The last two chapters discuss the relevance of all this to questions of policy. In certain places in this book I have permitted myself the liberty of making projections regarding the future of foreign enterprise and the prospects of foreign aid, and the future course of Indian economic development in general. I am fully aware of the limitations of such projects. I prefer to regard them more as working hypotheses rather than as enlightened speculations.

In the three years which have elapsed since this book was written, there have taken place many developments in the economy of the country, more particularly in the field of foreign investments. The new data relating to various aspects of the subject that have become available do not, I believe, basically alter the general conclusions of the study. It needs to be recorded here, however, that my worst fears, viz. the tendency on the part of the government to increasingly rely on private foreign investment have unfortunately proved true. It is not my purpose here to discuss this matter in greater detail, nor do I feel competent to suggest possible measures to reverse this dangerous trend.

In this study I have had the benefit of wise counsel and penetrating criticism from many people. It is my regret that it is impossible to mention all of them by name. I am particularly grateful for the help and encocragement which

many of my teachers and friends so generously gave me in the writing of this book.

For all the views expressed in this book, and for any defect that might have crept into the analysis, I hold myself entirely responsible.

K. M. K.

Chapter I

International Capital Movement: A General View

DURING the last one decade the growth of international indebtedness has been as significant as it was during the decades that preceded it. But what distinguishes international lending in recent years with that in the earlier periods is not the magnitude of the amounts involved, but the qualitative differences in the funds now made available and the significant variations in their impact on the recipient countries.

International lending has been, for centuries, an essential ingredient of the foreign economic policy of many of the advanced countries. It has been, for long, a subject of considerable interest both for the theorist and the layman. And yet, the theory and practice of international capital offers a wide field for further visits and exploration.

There is a noticeable degree of divergence of opinion among economists about the role of foreign capital in the economic development of underdeveloped countries. Opinions vary between the extreme positions of unconditional welcome to dogmatic opposition to foreign capital in all its forms and manifestations. Some people accept it as a panacea for the chronic ailments of backward economies, while others tolerate it as a palliative. Controlled and restricted expansion of foreign investments is insisted upon by some, while complete nationalisation is the solution suggested by others.

The existence of such a wide range of opinions about the role of international capital cannot be explained fully by

the differences in the political predilections of the economists. To a large extent, it reflects the confusion inherent in the theories of international capital movements which have been gaining currency in many quarters.[1] Even the use of the term 'import of capital', very often, gives rise to divergent denotations, nourishing confusion.

It is a commonplace that import of capital does not mean the transfer of physical currency from one country to another.[2] Again, it does not always refer to the import of physical capital, that is, in the form of machinery and equipment. Capital import should be understood as a process involving two transactions, the monetary transfer and the real transfer.

The initial transaction or monetary transfer is a transfer of purchasing power in the lending country in favour of the borrowers from the recipient country. That is, money incomes are made available for disposal by the borrowers. This represents the savings of the lending country, in the form of its own currency, intended ultimately for investment in the borrowing country. But, mere command over a portion of the money incomes in the lending country does not enable the borrower to make investments in the recipient country. This can happen when the borrower spends the borrowed funds in the lending country for purchasing goods, services or gold for imports into the borrowing country. The import of goods, services or gold constitutes the real transfer, the second stage in the import of capital.

This second stage in the import of capital does not always follow the first without an elapse of time. Sometimes it may be immediate. But there are instances where the ulti-

1. To quote Lundstrom, 'Economic literature provides many examples of fallacies in this field, which are made no less striking by having sometimes been advanced by economists and approved in the highest quarters' Hans O. Lundstrom, *Capital Movements and Economic Integration* (Leyden, 1961) 36.

2. Of course, in certain exceptional cases, such an export of currency does take place; for instance, the currency transfers by speculative traders during periods of chronic currency instability in a country. The historical example of currency movements across national boundaries under the gold standard has no parallel in the age of managed paper currencies.

mate transfer of goods or services take place long after the loan was contracted. Only when the funds are blocked indefinitely in the lending country does a transfer of commodities or services fail to materialise.

The transfer of title to purchasing power or claims on foreign currency is sometimes referred to as import of capital. For instance, the residents of a recipient country who have raised a loan through bond issue abroad may decide to deposit their funds in the banking institutions of the lending country rather than spend it on goods and services. From the point of view of the lending country, an export of long-term capital has taken place without consequent export of commodities and services. But the foreign assets in the lending country, in the form of bank deposits amounts to an import of short-term funds into the lending country which matches the original export of long-term capital. For the lending country a net capital export will take place only when the bank balances are ultimately spent, resulting in export of commodities, services or gold.

The intimate relationship between import of capital and import of commodities and services is now generally understood. It is, however, difficult to establish a clear-cut causal relationship between the two. Capital imports stimulate commodity imports; but the reverse is equally true. The relationship between the two is actually one of reciprocity.

One of the fallacies which have gained currency in economic literature on the subject relates to the 'export stimulating function' of tied loans. It is argued that the tying of loans ensures the utilisation of the loan proceeds for purchases in the lending country, thereby increasing the lending country's exports. This argument precipitates confusion, for, all capital exports, whether tied or untied, will have to be transferred abroad in the form of commodities and services. This is true even in cases where the loan transferred is to a third country. Whatever be the number of such transfers, the ultimate utilisation of the loan must result in an increase in the exports of the lending country. From the overall exports position of the lending country, therefore, there is little rationale for tying clauses in the loan

agreements. The function of tied loans, from the point of view of the lending country, is merely to ensure the export of particular commodities which the lending country wants to promote. In other words, it determines which individual industry or group of business interests in the lending country should be the beneficiary of export expansion. In the absence of the tying clause, the distribution of benefit resulting from the increase in exports cannot be adequately located. Very often, the function of tied loans is to ensure foreign markets and relatively higher export prices for particular monopoly interests in the lending country.[3] In certain cases it enables the producers in the lending country to unload their old and unsold stock of goods on the recipient countries at high prices.

The case for international capital movements has often been covered in economic literature with an elaborate fabric of abstract theorisations. One of the important arguments is that capital moves internationally from countries where the marginal productivity of capital is low to countries where it is high. This gives rise to a tendency towards equalisation of marginal productivities throughout the world.[4] This is considered a healthy tendency because it ensures 'efficient combination of the productive agents'[5] or the best utilisation of the capital resources in the world and consequently the highest possible level of world production and income.

The various facets of this argument deserve careful study. The argument implies a simple identity, namely, that the rate of interest is equal to the ratio of the marginal productivity of capital to the total capital involved. The determinant of the marginal productivity of capital is the supply of capital relative to the supplies of the other factors of production, mainly labour. In the advanced

3. Tying of loans, which is an important feature of the loans extended by capitalist countries, is actually a device by which the monopoly interests of the lending country uses the strong bargaining power of state structure to extract favourable terms from poor and capital-hungry countries.

4. Jacob Viner, *International Economics* (Illinois, 1951) 324.

5. Lawrence W. Towle, *International Trade and Commercial Policy* (New York, 2nd edn., 1956) 779.

countries, where capital is abundant and labour is relatively scarce, marginal productivity is low, while in the underdeveloped countries the reverse is the case. The main motive force for capital mobility being the rate of return, capital will flow from countries of law marginal prductivity and low interest rates to countries of high marginal prductivity and high interest rates.

The limitations of the above argument are many, particularly if the objective is to prepare a valid case for private international capital movements. Even a cursory examination of the level of interest rates in the various countries will show that interest rate differentials do not correctly reflect the relative scarcity or abundance of capital. The differences in the interest rates as between the nations is the product of a variety of factors such as the character and structure of money markets, the credit policies pursued by the financial and banking institutions of the country and the government's monetary policy. To assume interest rate differentials to be a mere function of relative quantity or supply of capital is an unnecessary abstraction suitable only for theorisation devoid of practical usefulness.

The assumption that higher interest rate or return on equity in the foreign countries compared to that in the domestic economy will result in international movement of private capital needs qualifications. No doubt, the possibility of higher profits has always been the prime motive for private international investments. In some of the advanced countries, capitalism has become 'overripe'[6] and capital cannot earn sufficiently high profit rates at home. In order to earn maximum profits, private capital moves to other countries. 'The securing of the maximum capitalist profit'[7] is the most important motivation of international private capital today. But in certain cases, interest

6. V. I. Lenin, 'Imperialism', *Selected Works* (English edn., 1950) I, Pt. 2, 495.

7. J. V. Stalin, *Economic Problems of Socialism in the USSR* (Moscow, 1952) 43-4.

or profit differentials have failed to provide adequate stimulus to investments abroad. It only highlights the fact that the motive force for private international investments is provided by a combination of considerations of which profit motive, no doubt, is the most compelling.

A consideration which sometimes assumes a great deal of importance in the investment decisions of private capitalists is the need for increasing their investments through regional or geographical diversification. The private investors may be willing to choose an investment opportunity abroad which provides less 'yield' but more 'security'. The preoccupation with 'security' considerations has been characteristic of international private capital, particularly in periods of international instability.[8] When such considerations seem to be more important than investment income, capital movements take the form of 'capital flight' or 'hot money transfers'.

The mobility of international capital in an 'up-stream' direction, that is, from high interest markets to low interest markets, is not limited to flight of capital in periods of political and economic instability. Even in normal conditions, 'up-stream' movement of international capital may take place, depending upon the weight which private investors give, in their decisions regarding investments abroad, to considerations other than yield and security. For example, private companies in the lending countries may establish branch business abroad to maintain, gain, or to prevent the loss of foreign markets.

Apart from the objective of cultivating export markets, foreign investments may also be made for securing the import of raw materials into the lending country to sustain the investors' domestic industries. Sometimes, foreign subsidiary companies are floated, mainly with the objective of getting around tariff walls and trade barriers and to enjoy

8. A substantial portion of the international capital movements during the inter-war period—a period characterised by the fear of another war, restrictive practices in trade and finance by various governments, internal inflation and external currency instability—took place for reasons of investment security.

the direct benefits of protection.[9]

The tendency towards equalisation of interest rates and marginal productivity of capital between countries, in any case, cannot be corroborated by real facts. Such a tendency does not apear even in the case of interest rates within a country. Regional differentials in interest rates exist in practically every country; they do not show any marked tendency towards equalisation.

It is interesting to note that the argument based on international equalisation of marginal productivities is an extension of a similar argument relating to gains from factor mobility within a country. The conventional argument, based on the assumption of a competitive economy, runs on the following lines: The rate of return on capital will be the highest in those industries which cater to the strongest consumer demand. Capital will naturally move into those industries because of higher profitability in such industries. The allocation of savings among the various alternate investments will be in such a way that the marginal value productivity of capital is the same everywhere. And since it gives the maximum output and income, it is the most efficient way in which productive capital may be distributed among the various investment fields.

The theoretical validity of the above argument, within the framework of a number of restrictive assumptions, is not open to question. But, then, the usefulness of theory to questions of policy and practice has to be judged not from its internal consistency and logic based on unreal and untenable assumptions, but on its ability to offer an adequate explanation of existing phenomena.

It can be demonstrated that the above theory does not offer a correct explanation of the phenomenon of international movement of private capital in the present age, the

9. After the Ottawa Conference of 1932, which introduced Imperial Preference, a number of American companies started business concerns in Canada to produce commodities which could enter the European countries under preferential tariff. The establishment of 'India Limiteds' by foreign companies was, in eertain cases, to enjoy the benefits of protection which were intended for Indian industry.

age of monopoly capitalism. The theory is based on the gains from factor mobility theoretically expected in a sufficiently competitive economy, and fails to encompass the rigidities involved in a monopolistic or oligopolistic economy.

No doubt, a certain degree of factor mobility is present under monopoly capitalism. Outflow of capital from one sector of the economy to another takes place and consequently there is a tendency towards equalisation of profits and interest. But the effective operation of this tendency comes into conflict with the basic economic law of monopoly capitalism, the law of maximum profit. Thus, the dynamics of a monopolistic or oligopolistic economy inhibits and distorts the tendency towards profit equalisation.

The inadequacy of the theory is completely exposed when we try to apply it to a recipient country which has accepted the goal of deliberate industrialisation through national economic planning. In the context of planned economic development, consumer preference and rate of return are inadequate guides for the rational allocation of capital among alternate investment fields within a country. Again, the existence of inequalities in income and wealth within a country distorts consumer demand by conferring an undue bias in favour of the luxury consumer preferences of high income groups.

The attempt to extend the conventional theory of capital mobility within a country to encompass the international movement of private capital encounters similar difficulties. The wide range of inequalities in income as between the advanced and the underdeveloped countries and the tendency towards an accentuation of the income gap are basic facts to be reckoned with in any attempt to understand the phenomenon of international capital investments.[10]

The increasing disparities between the income levels of

10. Gunnar Myrdal is among the few economists who have highlighted the need for merging the problems of underdeveloped countries and the problem of international capital movements (Gunnar Myrdal, *Economic Theory and Underdeveloped Regions*, London, 1957, 16-29). See also his book, *An International Economy*, 15-16.

the advanced capitalist countries and the those of the economically backward countries reflect an inherent weakness of the capitalist system.[11] The dynamics of a capitalist economy and the world capitalist system in general operate in the direction of an accentuation of income inequalities. Basing his arguments on the acceleration principle, Yasuma Takata maintains that 'Advanced countries develop because they are advanced and backward countries fall behind because they are backward.' He observes that 'At present the acceleration principle is working in the direction opposite to international levelling-off.'[12]

Under private enterprise, new investments tend to be concentrated in regions where economic development has already taken place to a sufficient degree rather than in underdeveloped areas.[13] The productivity of capital being larger in areas providing a variety of external economies, such a trend is to be expected. The 'economies of concentration of industry'[14] provides an important stimulant to international private capital and consequently it tends to flow into countries where an industrial base already exists. Such 'perverse'[15] capital movements accentuate the existing inequalities between countries. This, in turn, promotes further perverse movements, thereby completing a cumulative vicious circle.

It is also important to note that marginal productivity of capital may be higher in countries of relative abundance of capital rather than in countries of capital scarcity, a possibility which the conventional theory failed to encompass. The tendency of international capital to move into already industrialised countries, rather than to under-

11. V. I. Lenin, *Collected Works* (Russian edn.), XXX, 269.
12. Yasuma Takata, *The Acceleration in Underdeveloped Countries*, Paper submitted to the 13th Conference of the Institute of Pacific Relations, Lahore, 1958 (Japan Institute of Pacific Relations, 1958, mimeographed) 3, 8.
13. United Nations Economic Commission for Europe, *Economic Survey of Europe, 1954*, 142.
14. Bertil Ohlin, *Interregional and International Trade* (Massachusetts, 1952) 203.
15. Lundstrom, n.1, 57-8.

developed countries, is a fact which is generally understood. The substantial investments of American private capital in Canada and Western Europe is a case in point.

In the context of planned economic growth in the underdeveloped countries, there may be sectors which are more 'productive' from the national point of view, but which are not attractive to private investors because of low rates of return. The concept of micro-productivity or productivtiy for the individual firm is not generic to the problems of planned and deliberate industrialisation in underdeveloped countries. What is important is macro-productivity determined by the priorities of the development plan. It is clear that the movement of private international capital into sectors of high productivity need not always result in the most efficient or optimum utilisation of the capital resources. The case for international mobility of private capital, based on the equalisation of private marginal productivity of capital throughout the world is, therefore, not strictly valid, particularly in the context of the underdeveloped countries which have accepted national planning.

In the economic relations between the advanced capitalist countries and the underdeveloped countries, the case for capital movements lies in the international redistribution of income and wealth. International mobility of capital is justified if it is capable of reducing economic inequalities between the two groups of countries.

The above case is based on an extended application of the principle of progressive taxation. Rich countries should be 'taxed' heavily in order to raise finances for the economic development of poor countries. The advanced countries have not only a stake in the economic development of underdeveloped countries, but also an obligation in providing for their development.[16]

16. This is strengthened by the fact that some of the advanced countries of today attained their development, to a large extent, through the economic exploitation of colonies under their sway. Economic aid to the underdeveloped countries may be considered as a process through which the incomes originally transferred from the colonies to the mother countries are being returned to their rightful owners.

Any scheme for the international redistribution of income and wealth will pose a variety of problems. In the absence of an adequate world democratic political process which can decide the manner in which the burden of international financing should be distributed among the lending countries, the proposal lacks practicability. The facts of international lending today reveal the tendency of capital from many rich countries to flow into countries which are already rich rather than to countries which are poor. Such 'sharing between the rich' seems to be an inherent weakness of international private capital flows from the capitalist countries.

Further, there is the inevitable difficulty, which involves a psychological problem, namely, that some individuals, groups or regions in the underdeveloped countries may be richer than their counterparts in the lending country. The problem will be aggravated if the individual, group or region receiving aid happens to be richer than the individual, group or region in the lending country which contributes to the aid.

Any attempt to reconstruct the theory of international capital movements to suit the economic conditions of planned economies must rest on concepts which are generic to the problem of planned economic development. For instance, the concept of marginal social productivity must replace the concept of marginal private productivity—a concept which reflects the free market mechanism of the private enterprise economies. No doubt, in countries such as India, where planning is attempted within the framework of a mixed economy, with a substantial private sector coexisting with a large public sector, the notion of private marginal productivity and the 'maximum profit' motivation of private capital will continue to have some operational validity. But if the case for international capital movements is to be based on the maximisation of national and world incomes, productivity of capital must be viewed largely from the social or national point of view and determined by the priorities of the national plans. Again, international mobility of capital between planned economies

must be conceived of as an integral part of planned international division of labour.

International division of labour within the framework of a group of planned economies essentially means the specialisation of individual countries in the production of particular commodities and the complementarity of these countries with each other through mutually beneficial trade. Such specialisation is not based on the traditional static concept of comparative cost; nor is it akin to the pattern of specialisation which insists that the now agricultural and primary producing underdeveloped countries should remain in that position without resorting to industrialisation. On the other hand, international specialisation in the context of planned economies assumes a high degree of industrialisation and balanced development within each country. Further, it is based on dynamic changes in comparative cost brought about by changes in technology and the development of the productive forces.

It is a commonplace that international specialisation has much in common with specialisation between regions within a country. Certain elements of differentiations between international trade and interregional trade are common to market-oriented private enterprise economies as well as planned economies. Differences in currency standards and price systems, differences in customs and traditions, etc., make international trade distinct from interregional trade. But in the context of planned economies, there is a further differentiation which is of crucial importance. The individual countries have their own national economic plans under which resources are allocated to various sectors and regions according to the priorities set up by the national plan. Within a country the central planning authority has complete or sufficient control over the planned allocation of resources between sectors and regions. But the determination of the field of specialisation and the allocation of resources between politically independent countries involves the voluntary coordination of the national economic plans of the various countries.

International division of labour based on coordination of

the economic plans of the various countries can ensure the rational use of their productive capacities and human resources,[17] and the minimisation of the cost per unit of output. While international specialisation between advanced capitalist countries and the underdeveloped countries is characterised by increasing inequalities between them, international specialisation between planned economies can bring about a levelling-off of the income levels of these countries through international movement of capital and through the operation of the law of planned proportional development. It also ensures the maximisation of income in individual countries and the group of planned economies in general.[18]

The international exchange of commodities is treated in traditional analysis as the major aspect of international division of labour and specialisation. The role of international factor movements in facilitating such specialisation has remained a neglected aspect of conventional theory.

In the economic relations between planned economies, the international mobility of capital embodies the highest form of specialisation. A country which has comparative advantage in the production of a particular commodity on the basis of available natural resources, geographical location and labour supply may find it difficult to achieve specialisation and expanded reproduction due to the scarcity of capital resources. Capital inflow from other countries where capital is relatively abundant will enable it to expand its productive capacity and achieve specialisation to a degree which would not have been possible in the absence of foreign capital inflow.

The complementary relation between international capital assistance and international exchange of commodities,

17. V. Gorelov, 'The Role of Scientific and Technological Collaboration Among the Lands of Socialism in the Development and Reinforcement of the World Socialist Economic System.' *Voprosi Ekonomiki*, trans. in *Problems of Economics*, II, No. 2 (June 1959) 51.

18. O. Bogomolov, 'The International Socialist Division of Labour.' *Voprosi Ekonomiki*, No. 1, 1960, trans. in *Problems of Economics*, III, 2 (June 1960) 44.

as evidenced in the scheme of international division of labour between planned economies,[19] highlights a new aspect of the theory and practice of international capital movements, namely, the role played by 'trade' in a system of mutually beneficial aid. It is estimated that a 10 per cent rise in the volume or price of exports of the underdeveloped countries would have the effect of providing foreign exchange resources double that of the present total inflow of foreign capital, both from private and public sources, into these countries. For the underdeveloped countries which are largely dependent on primary products for their export earnings, even a stabilisation of the export prices would be a significant form of aid.

The inadequacy of a foreign aid programme which does not take into account the need for integrating it with foreign trade policies is revealed by the following statistics. During the American business recession of 1957-8, the prices of export goods of the underdeveloped countries fell by about 7 to 8 per cent. The decrease in the export earnings of these countries was accompanied by a continuous increase in the price of manufartured goods imported into the underdeveloped countries. The total loss incurred by the underdeveloped countries amounted to the total financial aid received by them from the World Bank during a period of six years.[20] The adverse changes in the underdeveloped countries' trade account,[21] brought about by the business depression in the advanced capitalist countries,

19. About the foreign capital assistance programmes of the centrally planned economies, the *World Economic Survey, 1960*, observed that 'The character of foreign capital flows underwent another change in 1958 in connexion with the greater coordination of long-term planning achieved through the Council of Mutual Economic Assistance. This coordination took the form of agreements providing for inter-country specialisation in various fields of activity and thereby affected the composition of foreign loans' (United Nations, *World Economic Survey, 1960* (New York, 1961) 122).

20. *Ibid., 1958*, 7.

21. During the recession of 1957-8, 'In some countries, such as Rhodesia and Nyasaland the fall in commodity prices... reduced earnings to such a point that development plans (were) cut' (see *The Financial Times*, London, 24 September 1958, 7:2).

thus completely nullified the entire aid advanced by these advanced countries to the underdeveloped countries over a period of several years.[22]

The planned economies comprising the world socialist system, on the other hand, offer an element of stability in the foreign trade accounts of the underdeveloped countries. The purchases by the Soviet Union, for instance, had a favourable effect on the prices of certain commodities such as black pepper, coir manufactures and vegetable fibers. During the recession of 1957-8, countries such as Malaya, Ceylon and Indonesia were saved from the adverse effects of declining demand for rubber in the Western countries by a significant expansion in Soviet purchases.[23]

In comparing the foreign economic aid programmes of private enterprise economies and planned economies, 'aid through trade' is as important a consideration as direct financial aid. In any attempt to find out the impact of foreign economic assistance on recipient countries, the effects of beneficial trade must enter into the calculations of net benefit.

The role of international capital movements, in general, may be best enunciated in terms of the relative benefits and costs. In general, it may be stated that international capital movements involve a two-day traffic in which there are repercussions on both the lending and borrowing countries.

An attempt to calculate the extent of advantage or disadvantage to the lending as well as the recipient countries necessarily involves a detailed analysis of the different items

22. The phenomenon of business cycles is an inherent weakness of the capitalist economic system, the adverse effects of which are transferred to the underdeveloped countries through fluctuations in the demand for their goods. And the United States, the major creditor-country in the world 'has proved to be the most vulnerable to postwar cyclical fluctuations of all the major industrial countries. The 1960-61 recession (was) the fourth in twelve years' (see *ibid.*, 1960, 41).

23. *The Financial Times* (15 August 1958) reported 'a quiet but significant rise in the London price of rubber.... Russian buying of rubber is considered the principal reason for the price rise' (see 2:1). See also *ibid.*, 20 May 1958, 2:1 and 24 September 1958, 2:1.

that constitute 'benefit' and 'cost'.[24] From the point of view of the lending country, the benefits of lending abroad are the investment income received on the capital, the favourable effects on exports, the possibility of ensuring the imports of essential raw materials and other products, favourable effects on the lending country's national income, and employment, and political and foreign policy advantages, On the side of cost are to be included the possibility of complete loss of investments through default or expropriation, and the problems associated with the ultimate transfer of the funds into the lending country at the time of the repatriation or amortization of the debt.

The benefits that the recipient country can acquire, on the other hand, are the additions to real domestic product and employment, the absorption of technical know-how, favourable effects on the foreign exchange position, etc. The outflow of investment income, the adverse effects on the balance of payments and the concentration and extension of foreign monopoly hold on the domestic economy, show themselves on the side of 'cost' incurred by the recipient country.

The export of capital by the advanced countries to the less developed countries is definitely not a matter of charity. The desire on the part of the donor country to help the economic development of recipient countries may be one of the considerations, sometimes an important consideration, but very often not the compelling one. The fact that the advanced countries export their capital abroad largely

24. A cost-benefit analysis of this nature, involving a broad definition of cost and benefit is, of course, a difficult proposition. The relative benefits and costs are sometimes not amenable to quantitative measurement. Particularly when political and other non-economic considerations are involved in lending and borrowing, it will be impossible to determine the exact magnitude and nature of benefit and costs.

The difficulties are not very much minimised by taking economic variables only. For example, the contribution of foreign capital to the real domestic product of the recipient country is not subject to easy calculation if we take into consideration the secondary effects of investment and other indirect effects such as the contributions to technical skill and expertise. Further, if cost is to be considered as a 'opportunity cost' as well, the analysis would, obviously, involve a number of imponderables.

in response to their own national self-interest is not sufficiently known, probably because of intense propaganda to the contrary.

A direct form in which foreign investments contribute to a lending country's economy is the receipt of investment income such as profits, dividends and interest. In general, the lending country secures a higher rate of return on its foreign investments compared to that on domestic investments. In other words, there is an increase in the marginal productivity of capital as a result of the change in location of the investments.

The effects of foreign investment on the exports of the lending country can be easily discerned.[25] From a short-term standpoint, lending leads to an increase in exports due to the intimate relation between capital exports and commodity exports. The European League for Economic Co-operation, in one of their studies admits that '...national [and European] interest dictates the export of private capital and techniques, since this is generally followed by that of goods.'[26] The long-term effect is that investments abroad increase the income in the recipient countries, part of which is likely to be spilt over to imports from the lending country. Moreover, the foreign operations of the investing companies provide intimate knowledge about market conditions in the recipient countries which helps in promoting the lending country's exports to these markets.

Foreign investments help the lending country also to develop its sources of import goods. This is made possible not merely through the trade connections that accompany investments abroad, but also through the development of the recipient country's productive capacity with regard to

25. About the United States, the Randall Commission admitted that 'United States investment abroad, public and private, provides additional markets for United States exports' (United States, Commission on Foreign Economic Policy, 1935, *Report to the President and the Congress* (Randall Commission Report), Washington, D.C., January, 1954, 25).

26. European League for Economic Cooperation, *Common Protection for Private International Investments* (Publication No. 25, February 1958) 9.

commodities which are needed for the lending country.[27]

The effects of foreign investments on the lending country through a change in the terms of trade has been a matter of concern for many economists. J. M. Keynes in his equation of gain from foreign lending considered the worsening of terms of trade consequent upon capital export (a decline in the marginal efficiency of the factors of production in obtaining foreign goods through trade) as a negative magnitude, to be deducted from the gain in the marginal productivity of capital (higher investment income) to obtain the value of net gain for the lending country.[28] Keynes' analysis of this matter is based on a short-term view. For instance, he did not take into account the long-term effects of foreign investments in providing a favourable terms of trade at the time of repayment of the debt, which offsets the original worsening of the terms of trade. If we also include the favourable effects on terms of trade which follow from the receipt of investment income, it is clear that foreign investments tend to turn the terms of trade in favour of the investing country.[29]

It is generally argued that foreign investment can promote the general welfare of the lending countries through increases in domestic income and employment. About the beneficial effects of US investments abroad, the Randell Commission stated:

> ... the economic welfare of the United States would itself be directly promoted by an increased movement abroad of sound investment by the United States nationals and corporations. Such a flow... would assist in the maintenance of high levels of economic activity and employment within our own country.[30]

27. Foreign investments have benefited the United States economy by ensuring the import of certain raw materials and minerals such as petroleum, nickel and copper and also of certain food articles not readily produced domestically such as bananas.

28. J. M. Keynes, *A Treatise on Money* (London, 1930) 343-5.

29. For a discussion on Keynes' equation of national gain from foreign lending, see Charles R. Whittlesey, 'Foreign Investment and National Gain', *American Economic Review* (September, 1933) 466-70.

30. United States, n. 25, 16.

increase in income, no doubt, occur as a result of expansion of exports. The theoretical justification for a policy of exporting capital and thereby promoting high levels of income in the lending country via high commodity exports has been provided by the writings of a number of American economists.[31] Based on the concept of the 'foreign trade multiplier', theoretical arguments are advanced for a favourable balance of trade through capital export in order to sustain high levels of business activity and income in the United States.[32]

As foreign demand for the lending country's commodities increases, the cost of production of these goods may be expected to diminish, thus stimulating the growth of the industries concerned. Again, foreign investments, through their contributions to productive capacity abroad, enable the lending country to obtain the imports of raw materials and other commodites essential for economic growth in the lending country.

For countries in which domestic savings tend to outgrow the possibilities for profitable domestic investment, capital exports act as an economic stabiliser. As Alexandrovicz pointed out,

> ... industrial countries with a high level of internal savings experience a reduction of economic activity if capital, goods and services are not exported in sufficient quantities to regions where productive resources lay idle.

31. Fritz Machlup, *International Trade and the National Income Multiplier* (Philadelphia, 1950) 214-8; see also John M. Letiche, *Balance of Payments and Economic Growth* (New York, 1959) 291.

32. It is sometimes argued that exports of the United States have no significant impact on its national income, the share of exports in national income being only about 5 per cent compared to anything between 10 per cent and 40 per cent in the case of many other countries. But actually, the overall figure of 5 per cent for the United States conceals the significant impact of exports in particular branches of production. For example, exports in 1952 accounted for about 43 per cent of wheat, 30 per cent of cotton and 22 per cent of tobacco. In the case of manufactures, exports as a share of domestic production in 1951 was 35 per cent in rolling-mill machinery and parts, 23 per cent in tractors, 22 per cent in sewing machines, 17 per cent in oilfield machinery and 16 per cent in motor trucks and coaches (see Henry William Spiegel, *Current Economic Problems*, Illinois, 1955, 523).

> Again, if governmental and inter-governmental action and guarantees do not help to move capital out from actual or potential creditor countries, a threat of depression may follow and anyhow the further development of these countries is not encouraged.[33]

This has been particularly true of colonial investments. The access of colonies provided the advanced countries with an automatism to tide over unemployment and depression in their economies by channelling their idle savings to investment in the colonies.

The possibility of diverting the entire savings of the advanced economies to investment channels meant that savings could always be equated with investment. As the conditions existed for ensuring that savings did not exceed investment, the propensity to hoard could be brought down to zero. Zimmerman has shown that this was the case with Britain before 1914. He stated that '... in the event the savers in Great Britain were not able to invest their savings at home they had—during the imperialistic epoch—a possibility to send their savings abroad.'[34] For the period 1880-1910, Zimmerman has established a negative relationship between home and foreign investments, a change in home investment of £1 leading to a change (in the opposite direction) of £0.826 in foreign investment.

Thus, the advanced countries have an economic necessity for exporting capital in order to prevent unemployment and to maintain higher levels of income in their domestic economies.

Foreign investment provides the channel through which the surplus savings can be pumped out, thereby minimising the possibility of depression and stagnation. Foreign aid offered by governments in the form of commodity assistance also has similar effects on the economy of the lending country. The problems created by over-production in certain commodities such as wheat and cotton are sought

33. Charles Henry Alexandrowicz, *International Economic Institutions* (London, 1952), 154.

34. L. J. Zimmerman and F. Grumbach, 'Saving, Investment and Imperialism,' *Weltwirtschaftliches Archiv*, 1953, Band 71, Heft 1, 9.

to be minimised through surplus commodity assistance.[35]

Apart from economic benefits, the lending countries often derive a variety of political and other non-economic advantages from international lending.[36] The multiplicity of objectives for which some of the lending countries of the world extend their loans and grants, include objectives such as 'the strengthening of military defence' and various short-term and long-term political aims.[37]

On the side of cost for the lending country, one has to mention the possibility that, in certain circumstances, the repayment of the debt may not be forthcoming. The complete loss of investments through expropriation or nationalisation is a pssibility that has also to be reckoned with.[38]

The lending countries may sometimes pose a real problem of balance of payments adjustment at the time of repayment of the debt. The increased volume of imports into the lending country consequent upon repayment may disrupt some industries if the imported goods happen to be competitive.

For the lending countries the balance of payments problem may sometimes be much more serious than the acceptance of an import surplus at the time when the recipient countries return the funds which they had earlier borrowed. A part of the capital investments abroad may be in sectors which provide raw material imports necessary for sustain-

35. This is particularly true of the commodity assistance offered by the United States government. While commodity assistance has certain beneficial effects on the recipient countries, particularly through counterpart funds, the programme has been, by and large, in response to the needs of the American economy (See Willard L. Thorp, *Trade, Aid, or What?* The Johns Hopkins Press, 1954, 32). The disposal of agricultural surpluses is one of the objectives of American foreign aid programme, listed by Mikesell in his study entitled, *Promoting United States Private Investment Abroad* (National Planning Association, Washington, D.C., 1957) 68.

36. Thorp, *ibid.*, 32.

37. Mikesell, n. 35, 68.

38. The default of portfolio investments during the war years and during periods of international monetary instability may be explained as an extraordinary phenomenon. Today portfolio capital has ceased to play any noticeable role in international capital movements. But, the possibility that foreign enterprise in many underdeveloped countries may be nationalised under the pressure of nationalist and socialist forces in these countries adds to the fear psychosis of international private capital.

ing the lending country's domestic industries. Again, the receipt of investment income (profits, dividends and interest) on the capital investments abroad will, in the ultimate analysis, be largely in the form of import goods. This may assume considerable proportions because a stage may come when the investment income received on the accumulated investments abroad exceeds the fresh capital exports every year.[39] Thus, the export of capital and the consequent multiplier effects through trade may signify not only a positive effect but also a negative effect in the long run, or a cost to the lending country.[40]

The operation of this negative tendency has not been viewed with complacency by the capital exporting countries. The large-scale assistance in the form of 'grants' offered by the US government to countries abroad has, as one of its motives, the solution of this problem.[41] American grants to foreign countries, while increasing the dollar earnings of recipient countries and thereby contributing to an expansion of American exports, do not involve the problem of import surplus in the future because grants need not be repaid. The solution of the problems faced by the American private enterprise has, of course, to come from the operation of the American state apparatus. For instance, the contribution of Marshall Plan aid, and the US governmental aid in general, leads to the minimisation of the 'dollar problem' is now widely recognised.[42]

The extension of US governmental grants to foreign countries, however, cannot assume massive proportions

39. Such a position, which is characteristic of the stage of maturity of capitalist economies, is particularly true in the case of the United States of America.

40. This anti-climax in the melodrama of 'foreign trade multiplier' is, no doubt, a sad reflection on the poverty of abstract theorisation which has recently gained currency in economic literature.

41. In the postwar period (up to June 1958) the US government gave assistance of 81.8 billion dollars to other countries. The favourable balance of trade of the US during 1945-57 ammounted to 79.6 billion dollars.

42. In 1947, before the beginning of the Marshall Plan, the world deficit amounted to 11 billion dollars; but it was reduced by almost half during the first two years of the Marshall Plan operations (see United States, n. 25, 3).

sufficient to withstand the increasing pressure on dollar. Moreover, a government wedded to private enterprise cannot evolve a system of foreign aid through grants which tries to eclipse the accepted goal of 'primary reliance' on private foreign capital.[43]

An effective solution of the problem lies in adjusting foreign aid and trade programmes on equal and mutually beneficial basis. The attempt on the part of the lending country should not be to assume the role of a mere 'seller' or to create a favourable balance of trade, but to conduct mutual international exchange of commodities beneficial to both the lender and the borrower.[44]

From the point of view of the recipient countries, again, the case for foreign capital depends upon the relative benefits and costs. For an underdeveloped country which embarks upon a programme of deliberate industrialisation and economic development, the need for foreign capital may arise from two main limitations of development finance. First is the problem presented by the inadequacy of available real capital resources (domestic savings at a level lower than planned investment).

In the writings of many economists, the quest for foreign capital resources has been sought to be justified on the ground that economic growth of the underdeveloped countries has remained at a low level because of the lack of domestic capital resources and the low rate of capital formation.[45] The underdeveloped countries are, by definition, capital-hungry or 'under-equipped with capital in relation to their population and natural resources.'[46] Hence the case for a policy of encouragement of foreign capital.

The lack of domestic capital in India and other underdeveloped countries cannot be considered as belonging to

43. The Randell Commission recommended the discontinuation of grants except under special circumstances.

44. The commercial credits and the various forms of capital assistance offered by the socialist countries conform, largely, to this pattern.

45. Colin Clark, 'Rate of Economic Development in Different Countries', *India Quarterly*, I (1948) 19.

46. R. Nurkse, *Problems of Capital Formation in Underdeveloped Countries* (Oxford, 1953).

the category of factors of production which are 'fixed' or which do not vary in relation to the changes in the relations of production and the economic structure of the country. But given the political, economic and social structure of most of the underdeveloped countries, it is fairly obvious that the governments of these countries are not in a position to mobilise domestic resources to the extent necessary for sustaining higher levels of per capita income. 'The economically underdeveloped countries are hindered in accomplishing plans for expanding their national economies by a shortage of internal resources'.[47] The need for external finance for the economic development of India was emphasised by the Planning Commission in the following words:

> India has a programme of development larger than can be financed from the resources internally available.... There will still remain certain shortages which woud tend to restrain the whole pace of development, and it is in meeting these that external resources will be of help.[48]

In their attempt to promote economic development, India and some other underdeveloped countries 'are compelled to make use of international economic relationships as channels for acquiring financial means and means of production.[49]

Even if we assume a superior economic system which can raise domestic capital formation to the highest level possible, the need for external resources may still be present. This is because the development of certain sectors of the economy is dependent on the import of machinery, intermediate goods, raw-materials and technical know-how which may not be financed through the normal channel of export surpluses.

47. N. Orlov, 'The Foreign Trade of the Soviet Union Under Present Conditions', *Voprosy Ekonomiki*, trans. in *Problems of Economics*, 5 (September, 1959) 32.

48. Planning Commission, *First Fice Year Plan*, 437.

49. V. Kondratyev, 'The Role of India's Economic Collaboration with Countries of the Socialist Camp in the Development of India's Economy' *Voprosy Ekonomiki*, trans. in *Problems of Economics*, 11 (March, 1959) 40.

Thus, we come to the second and equally serious problem of the inadequacy of foreign exchange resources (which means that the country's capacity to import capital goods and necessary consumption goods from abroad through the normal trade channels is limited): Since the developing country is likely to have a deficit in the balance of payments in the initial stages of economic growth, the import of foreign capital may become a necessity.

For the advocates of foreign capital, 'the reduction in consumers' sacrifice' is an oft-repeated argument. It is argued that if a country wants to raise capital formation without any cut in domestic consumption, the only alternative is foreign borrowing. Norman S. Buchanan puts forward this case in the following words:

> ... productive capital formation means cutting consumption or diverting resources from non-productive capital formation. But there is a limit here, and foreign borrowing many ease the burden by allowing consumption to be maintained at a satisfactory level through greater imports while productive capital formation proceeds.[50]

Even though the policy of reducing consumers' sacrifice is a commendable objective, it is doubtful whether capital formation (in the absence of foreign borrowing) should necessarily mean a cut in domestic consumption. In the context of economic realities in India and other underdeveloped countries, there exists the distinctive possibility that, given an efficient economic organisation, capital formation and rapid economic growth can be attained without any reduction in the consumption levels of the people.[51] But given the present economic and political institutions in India and most of the underdeveloped countries, domestic savings designed for faster rates of growth have inevitably to come from restrictions in the consumption front. The availability of external resources makes it possible for these countries to fulfil the high investment targets with-

50. Norman S. Buchanan, 'Deliberate Industrialisation for Higher Incomes', *Economic Journal* (December, 1946) 552.
51. Nurkse, n. 46.

out imposing any immediate sacrifice in consumption.

Among the benefits derived by the recipient countries from international capital imports, the direct contribution to development finance is, no doubt, a very important one. But the indirect and multiplier effects of such investments are no less important. The United Nations Report on the mobilisation of domestic capital asserts that 'External finance is necessary not only to increase the rate of development, but to act as a stimulant to domestic savings.'[52]

Whether foreign capital will act as a stimulant to domestic capital or not depends upon the nature and form of the investment undertaken, whether it is complementary or competitive to domestic investment.

The import of foreign capital or capital goods would, in certain cases, imply the simultaneous mobilisation of domestic capital. In the same way, the development of certain domestic industries necessarily involves the import of capital goods from abroad and the necessary finance from abroad to back such imports. There may be certain sectors of the economy or certain categories of industries which, due to lack of technical and industrial know-how or due to any other reason, could be started only by foreign industrialists. These industries may be essential for the development of domestic industries as well. All such foreign investments which supplement and strengthen the domestic sector or act as complementary lines of business activity may be classified under complementary foreign investments.

Competitive foreign investments are investments by foreigners in sectors where domestic capital is subjected to severe competition. In other words, if foreign capital enters an industrial sector where domestic capital is already entrenched, such foreign capital can be classified under competitive foreign investments.[53]

Capital, being a scarce resource in the underdeveloped

52. United Nations, Department of Economic Affairs, *Mobilisation of Domestic Capital in Certain Countries of Asia and Far East* (ECAFE, Bangkok, 1951) 224.

53. In certain cases, foreign capital may enter a field in which domestic

countries, wields a key position in the process of economic growth of these countries. The contribution of foreign capital to economic growth, therefore, deserves special mention.

An import of capital directly affects the income of the recipient countries. Whether real income will increase depends not only on where and how the foreign capital is utilised, but also on its repercussions on the rest of the economy. If foreign capital replaces domestic investments through undue business competition and monopoly practices, there may not be a net increase in the recipient country's national income. In the case of public foreign capital received by the government of a recipient country, the investment of foreign funds may sometimes be a substitute for investment which otherwise would have taken place domestically.

The role of foreign capital in the economic growth of underdeveloped countries is a marginal or peripheral one. The basic determinant of economic growth is the ability to mobilise internal resources and divert them to sectors which are pivotal to the economy for strengthening the productive forces. The decisive means and the primary stimulant for economic progress must invariably come from the domestic economy. Economic development depends upon a number of variables, apart from capital, such as the attitudes of the people to work, to save and to invest,[54] the strength and motivations of the productive forces, the willingness and enthusiasm for innovations, and social and political institutions. Foreign aid can, no doubt, provide 'a substantial supplement to their internal sources of accumulation'[55]

capital is already producing a substitute. Here, even though foreign capital may be functioning in a formally different industry, domestic capital which produces the substitute commodity will be left to the mercy of competition from foreign firms. Therefore, the term 'competitive investment' has to be understood in this wider context.

54. In economic jargon this gives propensities to save and invest. These are economic manifestations of attitudes and valuations which are deeply embeded in the very cultural heritage of a people (W. A. Lewis, *The Theory of Economic Growth*, London, 1956, 14).

55. V. Shchetinin, 'Economic Assistance of the Socialist Countries to Young National States', *Voprosy Ekonomiki*, trans. in *Problems of Economics*, 4 (August, 1960) 34.

The benefits derived by recipient countries from foreign capital investments are not limited to capital formation and income expansion. The domestic absorption of foreign technical know-how and managerial techniques, the possible expansion in employment consequent upon the enlargement of productive capacity, and the increase in exports resulting from increased productivity in the export sector, are some of the considerations which prompt underdeveloped countries to accept foreign capital.

The balance of payments problem associated with repayment and servicing of the foreign debt is, probably, the most serious element of cost for many recipient countries. Investment of foreign funds in productive channels does not necessarily solve the balance of payments problem. Within a country, a domestic investment may be productive in the sense that it is self-liquidating, that is, it generates sufficient income to enable the repayment of the capital and also the servicing of the debt. An investment of foreign capital may be productive in this sense, but to effect the repayment of the debt and for meeting the investment income charges, the generation of income in the form of local currency is not enough; repayment of the foreign debt requires foreign exchange. Since all foreign investments do not ensure this 'foreign exchange productivity', the repayment and servicing of debt often cause serious strain on the recipient country's international payments position.

A familiar argument that one comes across in economic literature on the subject is that a recipient country need not feel the burden of repayment and servicing so long as the lending countries continue to provide loans and other forms of capital assistance. This process of repaying a particular debt with the help of funds received from another loan, or what is called 'refunding', does not basically solve the balance of payments problem of the borrowing countries. Refunding solves the repayment problem of an outstanding obligation; but in that process, it creates a new obligation. This type of exchange of one creditor for another can go on so long as creditors are willing to underwrite the borrowing country's balance of payments by

making available increasing volumes of foreign funds. Refunding operations, in any case, do not amount to repayment, for, repayment involves the ultimate discharge of obligations and not a mere postponement of repayment through an exchange of lenders. Ultimate repayment would necessitate the creation of foreign exchange earnings through the transfer of goods, services or gold.

Very often, foreign capital may be forthcoming at conditions disadvantageous to the recipient country. The huge investment income transfer of private foreign capital, the secrecy with regard to the technical know-how covered by patent laws, etc., are some of the well-known perversions of private international capital.

The tendency of some of the creditor countries to extend international public capital in the form of 'tied loans' constitutes one of the sources of irritation for the recipient countries. In many cases, it may amount to a direct cost because the tying clause may stipulate the import of commodities at prices higher than what is prevailing in other countries. This means that the recipient country has to contract a larger loan than would have been necessary if the loans were contracted in the cheaper markets.

From the point of view of the recipient countries, the investment of foreign capital will involve a cost if such investments give rise to foreign monopoly concentration having adverse effects on indigenous industries and on the level of production in general. The tendency towards managerial concentration and cartelisation of business interprises are typical of private capital movements in the age of monopoly capitalism. For many underdeveloped countries, the import of private monopoly capital from abroad poses serious problems for the national industry and economic independence of the country in general. However, the political implications of private monopoly capital are generally concealed.

The general belief that private foreign capital does not have political compulsions emanate from the widely prevalent illusion about private capital transactions, namely, that it is 'business'. The concept that 'credit operation is busi-

ness', according to Gunnar Myrdal, has been the major 'taboo' or 'magical concept' nourished by private capital.[56] Private capital movements have often been mixed up with political considerations. The political motive force of colonial investments is a generally accepted fact.[57] Large monopoly firms in the advanced capitalist countries which wield considerable influence on the domestic policy of their governments, sometimes succeed in throwing the weight of the governmental apparatus in achieving positions of economic and political advantage in recipient countries abroad.

> A giant corporation not only often confronts a small and weak nation as the sole buyer of its exports or an important source of its imports (and/or credits); it is able alone or by making use of its own government's appropriate facilities to intervene actively in that country's internal politics, to buy, to install, or to depose its administration, to make or to break its politicians.[58]

Particularly for an underdeveloped country in the early stages of its independent economic growth, the impediments that foreign monopoly capital may place in the way of its economic independence give rise to serious concern.

The political strings attached to bilateral aid or government-to-government aid often place serious impediments to the underdeveloped countries aspiring for consolidation of their independence through national economic planning. A probable solution lies in 'internationalising' international capital through multilateral arrangements. Such denationalised lending will minimise the danger of political considerations superceding economic considerations and the

56. Myrdal calls this a 'functionally' or 'socially' useful concept, for, 'Without the fixed idea that credit is business, that profitability is important, and that there is a market where economic demand and supply for capital meet, international finance spills over to the intermediate ocean of power politics, where the crackpots and the demagogues swim with great pleasure' (Gunnar Myrdal, *An International Economy*, 112).

57. The study by Herbert Feis clearly brings out the political circumstances which guided the direction of international capital during the half century before 1914 (Herbert Feis, *Europe, the World's Banker, 1870-1914*, Yale University Press, 1930, 465-6).

58. Paul A. Baran, *The Political Economy of Growth* (New Delhi, 1958) 128.

needs and interests of the recipient countries. It will eliminate the political power of the rich country (in which the resources originate) from economic calculations regarding the desirability and feasibility of international lending. Moreover, multilateral lending can achieve a fair distribution of the burden of international aid among the various countries which are economically advanced. It will also ensure the availability of adequate capital for aiding the less developed countries as the resources of all the creditor countries will be centrally pooled.

The various considerations listed above, both from the point of view of the lending and the borrowing countries, jointly determine whether international capital movements will take place, in what magnitude and in which direction. The dynamics of international capital mobility are so complex as to nullify the validity of any abstract and simple analysis. International capital movements have to be explained not simply in terms of interest or profit rate differentials from country to country, but by the reciprocal benefits (and costs) for the lending and borrowing countries.

Chapter II

Impact of Foreign Investments on Indian Economy in British Period

THE early stages in the growth of foreign capital investments in India date back to the years of the East India Company. The volume of British capital imported into India during the regime of the Company, however, was very small.[1] Commercial capital was raised at low rate of interest, thus providing large profits to the Company's promoters and shareholders.

The earliest factories started by the Company in India were in centres of cotton supplies. The head English factory at Surat on the West Coast and the settlement on the Coromandal coast at Madras (then Fort St. George) bear testimony to this. After 1650 new factories were established on the Hooghly. Continental inland expansion continued over a long period of years and by 1805 the Company had established an empire including Bengal, North-West Frontier Province, Mysore and the Carnatic.[2] Most of the wars were financed by rupee loans mobilised in Calcutta from the Company's civil and military servants who had amassed considerable wealth through bribery and plunder. Some of the British concerns engaged in trade and exchange banking were also built up with capital raised in equally inglorious ways.

The export of British capital to India in the early period

1. The Company's trade in the eighteenth century was financed by Dutch capital.

2. These places were considered only as 'trading outposts' in the early eighteenth century.

was 'export' only in a restricted sense. Residents of Britain acquired a number of business concerns in India through rupee capital owned by British servants working in India. In like manner rupee loans were held by British nationals who had returned from India. These investments constituted British capital 'export' only in the sense of increasing Indian liabilities to British residents. In fact, they were 'simply portions of the Indian spoil and revenue reinvested in India'.[3]

The nineteenth century witnessed the growth of a vast network of British enterprise on Indian soil. Foreign capital flowed into many industrial ventures in India, mainly into tea, coffee and rubber plantations, jute, indigo and mining industries. Banking also attracted considerable amount of foreign capital. Railways occupied a unique position as a sector into which foreign capital flowed on a massive scale with the backing of the British state power in India.

The estimates of foreign capital relating to the early period of its growth are very scanty. All the estimates differ considerably from one another and it has to be assumed that they lack a certain degree of reliability. Even though industries were started in India with British capital and entrepreneurial skill as early as 1850, up to the year 1896 nobody undertook the task of ascertaining the volume of foreign capital in India.

Leland Hamilton Jenks who made a study of the migration of British capital in the early period gave a very rough figure of about £150 million as the volume of British capital invested in India during the period 1854-69.[4] According to his estimates British capital inflow into India took place at the rate of about £5 million a year during the seventies. The inflow reached its climax immediately after the Mutiny in 1857.[5]

A more exhaustive estimate of foreign capital was made

3 Leland Hamilton Jenks, *The Migration of British Capital 1875* (London, 1938) 208.

4 *Ibid.*

5 *Ibid.*, 225.

in 1896 by Edward Crammond.[6] His survey was concerned only with the quantum of British capital in India. He conducted four such surveys. According to his estimates foreign capital in India in 1896 amounted to Rs. 441 crores. Crammond's survey was followed by the survey conducted by Sir George Paish. His estimates of British capital in India and Ceylon related to the year 1909-10. The results of his survey were embodied in two interesting papers he submitted to the Royal Statistical Society in 1909 and 1910 respectively.[7] Sir George Paish's estimate came to a total of about £365 millions out of which the important sectors were government, railways and tea plantations.

H. F. Howard in his estimate of total British investments in India by 1911, put the total figure at £450 millions or Rs. 675 crores out of which government, railways and local bodies alone accounted for Rs. 440 crores.[8] As H. F. Howard himself acknowledged, 'the estimate is necessarily a rough one'.[9] The figures for the various sectors were arrived at by a cursory examination of the total capital in the respective sectors and making a reasonable estimate of the possible foreign share, it being 'largely a matter of conjecture'.[10]

Estimates of foreign capital in India have been made by many other individual researchers and agencies. Dr. V.K. R.V Rao in the mid-twenties attempted a detailed calculation and arrived at a total figure of Rs. 574.9 crores of foreign capital. Estimates of varying sizes have been arrived at by *The Economist* (London), Mr. G. D. Birla,[10a] *The Financial Times* (London),[10b] Findlay Shirras,[10c], Lord

6 Edward Crammond, 'British Investments Abroad', *Quarterly Review*, 428 (July, 1911) 45.

7 Sir George Paish, article in *Journal of the Royal Statistical Society*, I (2 January 1911) 182.

8 H. F. Howard, *India and the Gold Standard* (London, 1911) 95.

9 *Ibid.*, 96.

10 *Ibid.*, 92.

10a G. D. Birla 'Notes on the General Situation in India', *The Economic Journal*, Vol. XVI (September, 1932) 485.

10b *The Financial Times* (London), 9 January 1930.

10c Findlay Shirras, *Poverty and Kindred Economic Problems in India* (third edn., 1935) 22. See also, Findlay Shirras, 'The Situation in

Kinderslay,[10d] and the Associated Chamber of Commerce of India and Ceylon.

All these estimates suffer from a common limitation, namely, their lack of complete accessibility to all relevant documents relating to foreign capital in India. Since all these estimates were arrived at as a result of surveys conducted by individual researchers and agencies, the results could not be expected to be as accurate as any survey conducted by an official agency. The inaccuracies of earlier estimates were, in many cases, due to the lack of any clear-cut basis for estimating the investments in India of foreign companies doing business both in India and abroad. Moreover, because foreign capital entered India in many different forms, it was 'hard to arrive at even an approximate computatiton of the actual amount of the capital' and any calculation must have been 'largely guess work'.[10e] Table 1 gives a summary of the various estimates of foreign capital in India made prior to the Reserve Bank surveys.

Table 1

EARLIER ESTIMATES OF FOREIGN CAPITAL IN INDIA

Year to which the estimate relates	*Survey conducted by*	*Amount (Rs. crores)*
1870	Leland Hamilton Jenks	225.1
1896	Edward Crammond	441.0
1910	H. F. Howard	547.8
1926-7	Dr. V. K. R. V. Rao	574.9
1928-9	*The Economist*	354.0
1929	G. D. Birla	1,000.0
1929-30	Findlay Shirras	481.0
1930	*The Financial Times*	583.0
1930	Sir Robert Kinderslay	458.0
1931	Associated Chamber of Commerce of India and Ceylon	1,000.0

Looking down the list, it is difficult to arrive at any useful conclusion regarding the growth of foreign capital

India: A Rejoinder', *The Economic Journal,* vol. XLII (December, 1932), 572-3

10d Robert Kindersley, 'British Overseas Investment in India in 1931', *The Economic Journal,* vol. XLIII (June, 1933) 201.

10e *The Financial Times* (London) 9 January 1930.

investments over the period of years. Since 'none of these individual researchers had access to the mass of source material which has been collated and shifted by the Reserve Bank of India, they could be nothing more than intelligent guesses'.[11] Therefore, any attempt to find out the trends in the movement of foreign capital into India in the early period on the basis of these estimates should be well guarded.

The lack of comparable data over the period of years makes it extremely difficult to make any useful study of the trends in the growth of foreign investments in India in the British period. However, a study of the nature of foreign investments in the different sectors, the volume of foreign investments absorbed into these sectors, the benefits and costs involved in the capital investments and similar aspects will yield some important results.

Plantations assumed considerable importance as a sector which attracted foreign capital as early as 1839 when the Assam Tea Company, the first tea company, was formed with an authorised capital of £500,000. Foreign capital, almost entirely British, began to flow into the plantation industry on a gigantic scale after 1874. According to the estimate of Sir George Paish, foreign capital in the plantations in 1909-10 amounted to a total of £24.2 millions.[12] Another estimate placed the figure at Rs. 16 crores in 1910, out of which joint-stock companies registered in London had a capital amounting to about Rs. 2 crores as capital.[13] By 1914, the volume of capital increased to a total of Rs. 30 crores of which companies registered in London and those registered in India owned capital amounting to Rs. 26 crores and Rs. 4 crores respectively.[14] The total volume of capital increased to Rs. 34 crores in 1919, Rs. 35 crores in 1920, Rs. 48 crores in 1928 and Rs. 53 crores in 1930.[15]

Another important sector into which foreign capital flow-

11 *Capital* (Calcutta) 1 January 1951, 15.
12 Paish, n.7, 182.
13 *Production of Tea in India* (1910).
14 *Ibid.* (1941).
15 *Indian Tea Statistics.*

ed in the early period was the jute industry. The birth of the jute-mill industry in India dates back to the year 1855. It was in that year that the first jute-mill in India was established by an Englishman named George Aukland. It was run as a handloom industry in the beginning. The first power-driven jute mill in India was started at Barnagore in 1859 by George Henderson and Co. The total paid-up capital in the jute-mill industry increased from about Rs. 6.8 crores in 1912-13 to about Rs. 17.2 crores in 1922-3, to Rs. 20.3 crores in 1938-9 and to Rs. 25.3 crores in 1945-6.

The opening of the cotton and jute mills, and the development of tea plantations on industrial lines, all gave an impetus to the engineering industry. The report of the Industrial Commission of 1928 showed that there were 70 engineering workshops in India at that time mainly connected with railway construction.[16] The largest workshops were situated in Jamalpur and Bombay.

If we look into the early history of banking in India, it will be seen that the mercantile houses were acting as private bankers for the foreigners. The trading finance was in the hands of the Indian 'shroff'. In the early nineteenth century three Presidency banks were started with the Charter from the East India Company. These were the Bank of Bengal founded in 1809, the Bank of Bombay in 1840 and the Bank of Madras in 1843. In 1921 they were amalgamated into a single bank, the Imperial Bank of India. The special position which the Imperial Bank of India occupied in the history of Indian banking was the result of direct and indirect help from the government. The Imperial Bank was given the privilege of conducting all the general banking business of the government and this enabled it to expand its own business considerably.

In the field of ordinary banking in the nineteenth century there were only 6 joint-stock companies with more than Rs. 5 lakhs of capital and reserve. Their number rapidly increased in the twentieth century. There were 18 such banks in 1913 which rose to 27 by 1921. The increase

16 *Report of the Industrial Commission*, 1928, 26.

in capital and reserves was, over the same period, from £2.66 millions to £8.25 millions.[17] Apart from ordinary banks, exchange banks also began to be founded with foreign capital. Exchange banks were started in 1844, and by 1910 there were 5 such banks with 32 branches.[18] The number of exhange banks increased to 12 in 1913 and to 17 in 1921.[19]

The history of foreign private companies engaged in irrigation work offers us an example of the failure of foreign private enterprise to initiate economic development with its own momentum. The failure of all the private irrigation companies in the early British period is, indeed, an interesting episode in the history of foreign investments in India.

In the early British period, there were four foreign companies engaged in canal building. In 1863 an irrigation company named the Madras Canal and Irrigation Company was formed with a guaranteed capital of £1.6 million. The object was to construct a system of canals ranging from Tungabhadra to the Kistna.[20] But the inefficiency of the company was revealed in 1882 when it had a deficit of £2 millions. Therefore, the government bought over the assets of the company and thus ended the short history of the first foreign private company engaged in irrigation work in India.

Another company called the East India Irrigation Company which was formed in 1853 also ended with the same fate. This company had proposed to build a canal system in Orissa and to check the floods in the Mahanadi and other

17 Murray, 'Banking in India', *Journal of the Royal Society of Arts*, 1911, 271.

18 The five exchange banks were: (i) The Delhi and London Bank (started in 1844); (ii) The Chartered Bank of India, Australia and China (1853); (iii) The National Bank of India (1863); (iv) The Hongkong and Shanghai Banking Corporation (1866); (v) The Mercantile Bank of India (1893).

19 *Moral and Material Progress* (1923) 118.

20 About this company, L. H. Jenks wrote that they 'completed a canal thirteen years later, which could not be filled with water, and which there was no assured water supply to fill' (Jenks, n.3, 216).

rivers. The company started work in 1863. But by 1866 it had exhausted all its resources while the major part of the work still lay incomplete. Finally the government stepped in and purchased the assets of the company. The East India Irrigation Company had planned to build another series of canals, the Son Canals; but the proposal met with a premature death. The company had another venture to construct a series of canals called the Mid Midnapur Canals. But the government finally took over the company since the company failed in executing its work.

In the background of such continued failures of foreign private enterprise, a lot of re-thinking was done in governmental quarters, as a result of which a new irrigation policy was evolved. This new policy made it necessary for the state machinery to take up irrigation projects under state management. The growing opinion in official quarters in favour of state management of railways at that time gave greater force to the arguments in favour of this new irrigation policy. In 1866 it was decided to put the new policy into practice and to raise the necessary capital to finance these projects.[21]

The failure of the irrigation companies gave rise to serious doubts on the then existing belief in the superiority of the private enterprise economy. We cannot afford to forget the fact that the 'four great failures in the history of Indian irrigation were all works inaugurated by private enterprise'.[22] None of the private foreign companies were paying concerns. In their desire to accumulate immediate profits, the companies rushed into construction work without proper investigation and preliminary work. The complete neglect of even ordinary commercial considerations was characteristic of these so-called irrigation companies. This is evident from the fact that they 'did not study whether the areas required irrigation or whether there was a

21 Some of the important canals built under state management were the Sirhind, the Lower Ganges, Agra, Lower Swat, and Mutha Canals.

22 L. C. A. Knowles, *The Economic Development of the British Overseas Empire* (London, 1928) 374.

sufficient population to make the supplying of water a paying proposition'.[23]

The complete failure of all the private irrigation companies could have resulted in serious depression in the confidence of foreign investors in India's economic viability, but for the interference of the state. The state took over the ownership and management of private irrigation companies in order to minimise the disturbance caused to the British investors' confidence. To convince the British private investors the British government in India thought it fit to cover up the failure of individual British companies by bringing them under state management. Irrigation works in India in the British period were, thus, not the beneficial results of British private enterprise, but the achievements of British state power in India.

The starting of the railway system in India has been cited by many writers as the living example of the beneficial acts of British private capital. The role played by British private enterprise in the creation of the vast network of railways in India is often magnified to the point of exaggeration.

Attempts to start a railway network in India were made by British investors as far back as 1845.[24] About a dozen private companies in Britain came forward with proposals to build railways in India. Mention must be made of the East India Railway Company which was promoted by Macdonald Stephenson. Stephenson was, probably, the first person to plan railways in India.[25] In 1846, Lord Hardinge, the then Governor-General, recommended that the East India Railway Company be allowed to construct railways in India. To help the company in its ventures, he wanted free

23. *The Triennial Review of Irrigation in India*, 1918-21, 57.
24 Jenks, n.3, 210.
25 In his attempts to start railways in India, Stephenson had the backing of powerful companies and special interests such as Cockerill & Co., Palmer, Mackillop, & Dent (all of the Great East India House). Shipping interests such as the New Peninsular & Oriental, were also interested in the proposal to construct railways in India as it would stimulate India's foreign trade to their advantage.

land to be given to the company and to guarantee the capital raised by them.[26]

All these attempts, however, did not succeed and the construction of railways in India had to wait till 1835 when Dalhousie initiated a programme of railway development in India. The inflow of British capital into the railways in India took place on a significant scale after 1857. Table 2 shows the amount of capital expended on railways in India during the period 1858-1869:

Table 2

CAPITAL EXPENDED UPON INDIAN RAILWAYS (1858-69)
(£ millions)

Year	*Amount*	*Year*	*Amount*
1858	5.50	1864	3.80
1859	7.15	1865	5.40
1860	7.58	1866	7.70
1861	6.50	1867	7.00
1862	5.80	1868	4.50
1863	4.72	1869	4.40

Source: *Ibid.*, 219.

The predominant position of railways as a sector into which British capital flowed in large amounts was observed by Sir George Paish in his paper published in the *Journal of the Royal Statistical Society* in 1911.[27] As we have already noted, £136 million were invested in railways alone out of a total British capital in India of £365 million in 1910. Apart from the capital invested directly in railway companies, substantial amounts were lent direct to the government who, in their turn, utilised the money for constructing railway buildings. Therefore, part of the capital amounting to a total of £182.5 million on 'Government and Municipal' account, as given in the estimates of Sir George Paish, should be considered as the amount invested in the railway sector.

26 *Ibid.*, 210.
27 Paish, n.7, 182.

As we have already seen, the estimates of H. F. Howard showed that for the year 1911, government, railways, and local bodies accounted for Rs. 440 crores out of a total of Rs. 675 crores of foreign capital investments in India. The predominant position of railways as a sector into which foreign capital flowed in substantial volume was revealed in the estimates of Dr V. K. R. V. Rao, *The Economist* (London) and Sir Robert Kinderslay. The following table (Table 3) gives a brief summary of the position which government, railways and local bodies occupied in relation to the total foreign capital given in the various estimates:

Table 3

Year	*Estimate by*	*Total foreign capital*	*Government, railways & local bodies*	*Percentage of (4) to (3)*
(1)	(2)	(3)	(4)	(5)
		(In Rs. crores)		
1910	Sir George Paish	547.8	473.3	81.9
1910	H. F. Howard	675.0	440.0	65.2
1926-27	Dr. V. K. R. V. Rao	574.9	358.6	62.2
1928-29	*The Economist*	354.0	219.0	61.9
1930	Sir R. Kinderslay	458.0	351.0	76.9

The reason for such a significant inflow of foreign capital into the railway sector has to be found mainly in the peculiar system of railway construction in India in the early period. No explanation in terms of the 'marginal efficiency' of capital or the 'favourable differential' in the rates of profit in the capital-exporting country and the capital-importing country will hold good in this case. It should be remembered that the railways in India were never in the nature of a paying concern up to 1900. Still, British capital flowed into railways in India from 1853. This was made possible by a deliberate policy of encouraging British private capital into Indian railways on the part of the East India Company's government in India and later by the British government in India.

Lord Dalhousie who initiated this policy of encouraging British private capital understood the great risks that had

to be borne by the private entrepreneur or company which wanted to construct railways in India. He was certain that private British capital, left to itself, would not be in a position to venture into railway construction in India. Moreover, the determination on the part of the British to strengthen their economic interests in India demanded that British private investors be offered the most favourable climate in India for their investments. This 'favourable climate' included guarantees for future profits, minimisation of risks, etc. In his anxiousness to attract British capital and enterprise to India, Lord Dalhousie wanted private British investors to undertake the construction of railways in India under a system of guarantees. Lord Dalhousie wrote in his famous minute on the railways in 1853 thus:

> I submit that any time and money which the Honourable Court could save by undertaking such (railway) work itself would be well expended in securing the introduction at this time of a large amount of English capital and English energy so as to encourage by the successful issue which I contemplate for these railway undertakings, a more extensive employment of similar capital and similar efforts hereafter in connection with the products of trade of India.[28]

Thus, a deliberate policy of encouraging British private capital was initiated by Lord Dalhousie. Consequently, large amounts of capital were invested by Brtish companies in Indian railways. It was done under a system of government guarantee of interest. Guarantee was given for 5 per cent interest on the capital invested. Land was given free. As regards profits, that part of the profit which was over and above the 5 per cent interest guaranteed was to be divided between the private companies and the government. Without such a guarantee of interest and the provision of free land, private capital would not have taken the 'risks of such unknown enterprises and such expensive engineering as would be involved in crossing Central India or surmounting the Ghats'.[29]

28 *Lord Dalhousie's Minute on the Railways*, 1852-53, lxxvi.
29 Knowles, n.22, 338.

The railways in India for a long time were not paying concerns. Since the private railway companies never earned even the 5 per cent, the government had to earmark money from the budgetary sources to meet these deficits. By 1881 about £18 million were paid out from the government's budgetary resources as dividends under the system of guarantees.[30] Thus, the private British companies thrived on the savings of the Indian tax-payers. As Jenks admitted, 'It was the Indian tax-payer who had to pay for this progress. He had no voice in the matter.[31]

The inefficient way in which the private companies functioned, and the extravagance in their conduct of business made it imperative on the part of the state to assume direct responsibility in the construction and management of railways after 1899.[32] The state which began to function as an accelerator for the increased inflow of private British capital into Indian railways, thus, ended as the owner and managing authority of the vast railway network in India.

The inflow of British capital for railway construction in India was not an unmixed blessing. The extrapagance of private companies under the guarantee system meant a heavy cost to the Indian economy. The outlays on railway construction by the government were financed not only by loan capital from Britain, but also by taxes squeezed from the Indian tax-payers. Even the loan capital received from Britain did not benefit the country to the desired extent because the remittance of the funds did not take the form of consumer goods.[33]

It is important to note that railway construction by Bri-

30 *Annual Report on Railways in India*, 1881-82.

31 Jenks, n.3, 216.

32 For the British government and the British investors, the idea of government management of railways was, no doubt, quite strange in those days, particularly in the background of strong laissez-faire attitudes at home. The contradiction between laissez-faire at home and government control in India was more apparent than real. The provision of economic overheads like railways was essential for the expansion of British private enterprise in India. Since private investors failed to provide these overheads, by their own efforts, the British state power had to step in, thus promoting private enterprise.

33. Jenks, n.3, 227.

tish private companies and by the British government was carried out not with the objective of improving the indigenous economy, but with the objective of amassing profits and strengthening British trade and commerce in India.[34] But in the process of ensuring benefits for the mother country, British private enterprise and government power had to perform certain acts of grace beneficial to the Indian economy. As Marx pointed out in one of his observations on India, even though Britain developed the railways in India 'with the exclusive view of extracting at diminished expenses the cotton and other raw materials for their manufactures', it was not possible to 'maintain a net of railways over an immense country without introducing all those industrial processes necessary to meet the immediate and current wants of railway locomotion, and out of which there must grow the application of machinery to those branches of industry not immediately connected with the railways'.[35] Thus the railways in India became the 'forerunner of modern industry'.

The starting of the railways was, undoubtedly, one of the major events during the British period. The creation of a vast network of railways through the length and breadth of India during those years of primitive transport and communications had, of course, a farreaching impact on the country's economic development. It helped the process of economic integration in India and altered all the prevailing conceptions about space and time. The economic resources in the various parts of the Indian subcontinent were bound together by the new form of transportation. Raw materials could be moved to the industrial centres without much delay and at comparatively low transportation cost. Finished products could reach the markets and the body of consumers in far away places. Perishable goods could start

34. Jenks wrote: 'It will cause neither pain nor astonishment to say that Englishmen who invested in India intended to profit by the act, and to profit more largely than they could have done under the same conditions at home. But it is fair to point out that they had no idea of improving India in doing so' (*Ibid.*, 226).

35 Karl Marx, 'Future Results of British Rule in India', in Marx and Engels, *On Colonialism*, 19.

capturing new markets at long distances from the places of location. Labour became increasingly mobile. In short, most of the physical obstacles to economic transition in India were overcome.

These incidental benefits enjoyed by the Indian economy were pervasive so far as their ultimate effects on the economy were concerned. The development of railways in India, thus, laid the foundation not only of an expanding trade and consequent benefits for the British economy, but also interregional trade and the stimulation of auxilliary and related industries in India. Railways not only helped the British government to maintain political and military control over India, but also brought about political and economic integration and helped the creation of an all-India market.

It will, however, be wrong to characterise the direct and indirect benefits gained by the Indian economy from railways as the beneficial effects of British private capital. As we have already noted, the construction of railways in India was not the result, primarily, of the inner dynamism of British private enterprise, but the result of governmental action by the British state power in India.

The economic changes initiated by British private capital and the British government were, no doubt, farreaching[36] but they created a process of stunted growth for the Indian economy. Up to 1901, there were no manufacturing industries in India, with the exception of cotton and jute industries. The industrial development of India was centred not on iron and steel industries, but on jute and cotton and to a greater degree on railways.

In a study of the impact of foreign investments on the Indian economy in the British period, one is confronted with the problem as to how the effect of foreign capital during the British period can be isolated from the total effects of the foreign investment-cum-trade system which was, as a matter of fact, a unified system moulded by the

36 In a sense, British capital transmitted to India some of the direct effects of the Industrial Revolution.

financial and commercial policies of the British colonial administration. These policies were purposefully and deliberately formulated and executed with a view to effect a certain pattern of international flow of goods and finance between the mother country and the dependent colony.

The above point may be illustrated by reference to the competitive nature of foreign investments and their adverse effects on the indigenous economy. It is a known fact that the investment of British capital in certain industrial sectors in India in the early period resulted in the destruction of indigenous enterprises owing to the high competitive power of foreign firms. Even if British capital were not invested in India, the destructive effects on the indigenous economy would still have been present in the Indian scene due to the selfish commercial policy persued by the British government in India. Therefore, given the evidence that indigenous industries were destroyed in a particular sector, it is difficult to come to a definitive conclusion whether it was caused by British capital or by British commercial policy. In many cases, the net effect was the 'joint-product' of both these factors. In such cases of combined causative influence it is difficult for us to determine the exact role of each factor. The degree of causative influence exerted by British capital alone, in isolation to the British commercial policy, cannot be measured in any precise form. This proplem of isolating the effects of the over-all British capital-cum-commercial system is further aggravated by the lack of enough data relating to many aspects of the problem. However, this problem can be explained away by assuming that foreign capital during the British period had a special complexion, added to its basic elements, a special complexion added to it by the selfish commercial and trade policies pursued by the British state power in India.

It should be remembered that the starting of British factories on Indian soil, in effect, meant only a change in the geographical origin of British competition to Indian goods. Even before British capital was invested in India, the factories in Britain had succeeded in offering destructive competition to Indian industries. The starting of

British factories in India only brought the competitive element to the very doors of Indian enterprise. Therefore, the foreign investment-cum-trade system as a whole has to be studied in order to evaluate the impact of foreign investments on the Indian economy in the British period.

In pre-British India, villages were the bases of the national economy. Alongside the village communities India had developed an urban civilization. Though village communities represented the bulk of the Indian social structure, the towns that sprang up in important places of trade and commerce also supplemented the economic framework, especially in the field of artisan industry. The urban handicrafts industry of India was highly advanced and was capable of commanding an enviable position in the world market. As Claverton observed:

> From ancient days, when Indian fabrics, tapestries, gems, carpets, enamels and mosaics adorned the private and public buildings of Rome, down to the beginning of the Industrial Revolution, the world looked to India for its most arresting and exciting wares.[37]

Romesh Chandra Dutt has presented much the same view when he stated that 'India in the eighteenth century was a great manufacturing as well as a great agricultural country, and the products of the Indian loom supplied the markets of Asia and of Europe.'[38] These characteristics of the Indian economy raise certain pertinent questions. Was the Indian 'soil' fertile enough for a natural growth of capitalist industry? Was the imposition of foreign dominance over the Indian economy and the impact of foreign capital a hindrance to this natural growth of the economy?

It is conceivable that if India was left to herself without interference from British capital and political power, she would have advanced from an economy based on village communities and a small but vital sector of commercial capital to full-fledged industrial capitalism through the

37. V. F. Claverton, *The Awakening of America*, 18.

38. R. C. Dutt, *The Economic History of India* (7th edn., London, 1950) viii.

natural and indigenous process of development. The level of industrial and commercial development in India in the pre-British period points to the distinct possibility of such a natural growth. The existence of a vital segment of commercial capital in India, the destruction of many pre-capitalistic forms of production and the growth of indigenous industries are all pointers to this conclusion. But it is also conceivable that the economic changes in the absence of the British impact would not have been so rapid and all-embracing as what happened under the British. Can it be argued, therefore, that the early British firms were the real promoters and the pioneers of industry in India?

The truth in the argument that British capital helped India in the process of capitalistic industrialisation has to be recognised. There is no doubt that Indian economy in the pre-British period suffered from serious deficiencies. The rate of indigenous capital accumulation was low due to structural deficiencies such as the low productivity of the indigenous sectors leading to low margin of savings, the shift of income from saving classes to non-saving classes, and the absence of a well-organised banking system to channelise the existing savings. British capital and enterprise, therefore, had a positive role to play in initiating economic changes in a relatively stagnant economy. This 'regenerating role' of British capital, however, was accompanied by the 'destructive role' because the process of growth attained during the British period was stunted and uneven and at a very heavy cost to the indigenous economic structure.

One of the major effects of the investment of foreign capital on the domestic economy of India in the British period was the ruin of indigenous industries. British competition eliminated the competitive power of feudal industries in India and ruined the handicrafts industry. This directly followed from the fact that foreign investments in the British period were predominantly of a competitive nature. Moreover, the import of machine-made goods from Britain unleashed unequal competition on the village artisan industry. The fact that foreign goods were cheaper than

the final victory of foreign goods over the indigenous products. It was only natural, that even the members of the self-sufficient villages preferred foreign goods to the neglect of their own hand-made products. The cheaper goods which flowed from Britain and from the British industries on the Indian soil always succeeded in ousting the dearer ones provided by the indigenous industries. The construction of a wide network of railways facilitated the flow of British manufactured goods into the remote villages and thus further reduced the competitive power of the indigenous industries in India. The indigenous industries which had neither technical superiority nor the facilities of transportation had to face bitter competition from foreign goods. About this phenomenon, Buchanan wrote that the '...self-sufficing local economy has been displaced by international specialisation and trade much to the discomfiture of the Indian craftsmen'.[39] The destructive competition offered by the foreign sector in India was so severe that many indigenous industries were destroyed. In spite of severe competition, some indigenous industries struggled for a long time to eke out a bare existence.[40]

The policies pursued by the British government in India accentuated the difficulties of the domestic producers. In many places excise duties were charged with a view to eliminate the domestic industries which were already facing competition from foreign trade. Sri M. Visvesvaraya, referring to the plight of the Indian industries during the British period observed that excise duties imposed on Indian exports of indigenous goods like cotton had a penalising effect on the Indian industries. He pointed out that

> ...not only are cotton goods imported practically free, but the government actually imposes an excise duty on

39. D. H. Buchanan, *The Development of Capitalist Enterprise in India*, 130.

40. About the resistance offered by the indigenous sector, the Indian Industrial Commission observed: 'In India a far greater degree of resistance has been offered by the handloom to the aggression of the factory than in England' (*Report of the Industrial Commission*, 1916-18, 51).

> the products of the local mills to enable the British manufacturers to compete successfully with them. Nowhere else in the world would such an obvious attempt to handicap industry be tolerated.[41]

The foreign investment-cum-trade system during the British period, thus, had a competitive character with destructive effects. It involved a cost to the Indian economy in the sense that a number of indigenous industries were destroyed by the severe competition it offered.

In the wider context of domestic capital accumulation, the impact of the foreign investment-cum-trade sector had very serious implications. The destruction of the indigenous industries meant the reduction in the saving capacity of the native industrial and trading classes, thereby thwarting the process of domestic capital formation. This, in turn, accentuated the ruin of the indigenous sector. Thus the decacy of indigenous trades was both the cause and effect of the collapse of the native process of capital accumulation and the ruin of the indigenous business class.[42]

Another adverse effect of the foreign investment-cum-trade system was the break-up of India's trade. The importance of India to England in the early period lay in the fact that India supplied some of the essential raw-materials, oil, dyes, jute and cotton required for the industrial revolution in England, and at the same time, offered a growing market for English manufactures of iron and cotton at a time when the buying power of the Continent was restricted owing to the after-effects of the French wars. India also began to supply both tea and sugar. And as the English cotton manufactures expanded, the machine-made piece-goods were imported into India and took the place of the Indian cotton piece-goods which had been the mainstay of the Indian export trade.

The reduction in Indian exports of manufactured goods and the increase in Indian exports of raw materials for the benefit of British industries can be gauged from the

41. Sir M. Visvesvaraya, *Reconstructing India* (London, 1920) 5-6.
42. Nirmal Chandra Sinha, *Studies in Indo-British Economy Hundred Years Ago* (Calcutta, 1946) 30.

following statistics. During the period 1857-72, Indian exports of manufactured goods declined from 11 per cent to 3.3 per cent. During the same period the export of raw materials showed a considerable increase from 34 per cent to 61.4 per cent. In 1840-41 Indian exports of calicos, muslins and other cotton goods amounted to about Rs. 92 lakhs. But by 1850-51 it showed a sudden fall to less than Rs. 1 lakh. On the contrary, the exports of raw materials and foodstuffs increased considerably. This trend continued in the subsequent periods and by 1914, foodgrains were the most important single item of our export trade consisting of about 21 per cent of the total exports.

The structural changes that were effected in the pattern of India's foreign trade by the foreign investment-cum-trade system were detrimental to the interests of the Indian producers and traders. It also destroyed, to a great extent, India's ability to service the foreign debt and to pay for the tributes and Home Charges to the mother country. A warning to England was given by Henry St. George Tucker as early as 1818 about the possible difficulties in servicing foreign debt. He had warned that the Imperial system was geared to Indian manufactures as well as to Indian raw produce, and that income from both source was necessary for the Company to meet its tribute payments. He pointed out:

> I need scarcely repeat that India can only discharge her annual tribute to the mother country... by means of her produce and manufactures, and if this country (England) will not receive that produce at remunerative prices, the same amount of tribute cannot be raised.[43]

Colonel Sykes told a Select Committee in 1848 that 'It is only by the excess of exports over imports that India can bear the tribute'.[44] But the difficulties faced by the Indian economy in servicing the foreign debt or in meeting the payments of tribute and Home Charges did not attract the serious attention of the British authorities. The need for

43. Henry St. George Tucker, *Memorials of the Indian Government.*
44. Sykes, Quoted in Gorham D. Sanderson, *India and British Imperialism* (New York, 1951) 20.

creating an export surplus to service the foreign obligations was overlooked by the British to the utter disadvantage of the Indian economy. Gorham D. Sanderson narrates this sad story in the following words:

> British indrstrialists ignored Indian realities and used their influence to prohibit the export of Indian manufactured goods into England. By so doing, they destroyed one source after another of India's ability to pay the tribute and the expenses of the commercial government in India. The full burden of tribute and increasing mercenary then fell upon Indian agriculture.[45]

It would be wrong to say that the adverse trends in India's foreign trade were simply the result of the commercial policies pursued by the British administration in India. They were at least partly the result of the strong impact of British investments which turned India into a primary producing country for the benefit of the mother country. On this huge foreign investment system, commercial and political policies of the British government were superimposed to the utter disadvantage of the domestic economy of India.

The overall impact of foreign investments, as we have seen, was to turn India into a producer of primary products and raw materials. This structural change in India's foreign trade was accomplished in two ways. Firstly, the foreign investment-cum-trade system with the superior backing of the British state power in India destroyed indigenous industries and thereby eliminated indigenous goods, both manufactured and artisan goods, from the export arena. Secondly, the investment of foreign capital was predominantly in sectors which directly or indirectly stimulated the export of raw materials and primary products.

The cost incurred by the Indian economy on account of the destruction of indigenous industries and the disruption of India's foreign trade overshadows whatever benefits that resulted from the investment of foreign capital in industrial ventures in India in the British period.

45. Gorham D. Sanderson, *India and British Imperialism* (New York, 1951) 203.

It has been argued by many economists, basing their arguments on the postulates of the Classical School, that specialisation by the underdeveloped countries on primary products and raw materials has been, after all, beneficial to these countries. We have to test the validiy of this argument in the light of Indian economic thinking.

At the very outset, it should be mentioned that, since the argument in favour of specialisation of the traditional type is based on the static or cross-section concept of comparative advantage, it has to be rejected. We have to view this problem in a dynamic setting involving the continuous 'flow of Indian economic history'.

It will be wrong to say that the entire benefits of specialisation accrued either to the foreign countries or to the Indian economy. But it can be maintained that the benefits were not equitably spread over the investing countries and the recipient country, India—India standing to lose comparatively to the foreign countries. At any rate, we can assert that the flow of benefits from specialisation was never a one-way traffic. The increasing specialisation of India and other underdeveloped countries on raw materials further strengthened the concentration of manufacturing and industrial processes in the advanced countries, thus widening the gap in the income levels between advanced countries and underdeveloped countries. If we take into consideration all the adverse effects emanating from the imposition of the specialised primary production economy, we can assert that the overall effect of shch specialisation was positively harmful to Indian economy. This has been true in the case of all underdeveloped countries which were brought under the colonial yoke. As Singer points out,

> ... the specialization of under-developed countries on export of food and raw-materials to industrialised countries, largely as a result of investment by the latter, has been unfortunate for the underdeveloped countries.[46]

46. H. W. Singer, 'The Distribution of Gains Between Investing and Borrowing Countries', *American Economic Review*, 40 (1950), Papers and Proceedings, 47.

One of the main adverse effects of India's specialisation on raw materials and primary products (which was brought about by the impact of foreign investment-cum-trade system) was the adverse trend in India's terms of trade. This was, of course, part of a global trend common to all underdeveloped countries which came under the impact of colonial investments.

It has been observed from historical facts that the trend of prices has been continuously in favour of sellers of manufactured goods, while it has been continuously unfavourable to the sellers of primary products and raw-materials. Raul Prebisch has demonstrated that the terms of trade of countries specialising on primary products continued to deteriorate since 1870.[47]

Even though this historical fact is now generally accepted, there is little agreement about the causes underlying this phenomenon. One argument is that the adverse changes in the terms of trade of India and other underdeveloped countries has been the reflection of relative changes in the real costs of production in the primary producing countries and in the advanced countries specialising in manufacturing. In other words, the changing price relations were the direct effect of the changes in the real costs of the manufactured exports from the investing countries in comparison to the changes in the real costs of primary products exports of the underdeveloped countries.

The above argument in terms of changes in relative costs has to be dismissed. For, what really happened in the realm of production was the significant changes in productivity. It should be noted that, from the beginning of the Industrial Revolution in the West, productivity in the manufacturing sectors increased to a significantly great extent than productivity in the primary and raw material sectors. This

47. United Nations Economic Commission for Latin America, *The Economic Development of Latin America and Its Principal Problems* (New York, 1950).

For data regarding the deterioration of the terms of trade of primary producing countries, see the following United Nations publication: *Relative Prices of Exports and Imports of Underdeveloped Countries* (December, 1949) 22.

has been true even about industrialised countries themselves. Obviously, it must have been true to a much greater degree in India and other underdeveloped countries.

Since the disparity between the productivity of the manufacturing sector and the productivity of the primary and raw material sector was the underlying cause of deteriorated terms of trade in India, it reflected itself in the form of a disparity in the levels of domestic real incomes.

Another cause of the adverse terms of trade was the element of monopoly and monopsony possessed by the foreign investors and traders in India who were in a position to suppress the price of India's primary products. This was, of course, part of a general pattern in all the underdeveloped countries. As Myint has observed:

> ... in the typical situation where foreign enterprises in the backward countries are large enough to be monopsonistic buyers of labour and peasant produce, their behaviour may depress the terms of trade. Thus they may meet the pressure of competition in the world market by cutting prices rather than output and by pressing down on the internal incomes of backward countries while maintaining their 'normal profits' on an unreduced volume of output.[48]

The element of foreign monopoly in India eliminated the pressure of Indian producers of primary products for higher profits and higher income.

The differences in the elasticity of demand, both income elasticity and price elasticity, for manufactured goods and that for raw materials and primary products also helped the adverse changes in the terms of trade. The effects of changes in income on demand for manufactured goods significantly differed from the income effects on the demand for raw materials and primary products. Increase in real income resulted in a more than proportionate increase in the demand for manufactured goods and only a less than proportionate increase in the demand for raw materials and primary products. In other words, the demand for food

48. H. Myint, 'The Gains from International Trade and the Backward Countries', *The Review of Economic Studies*, 1951, 129.

and other primary products were not very sensitive to changes in real income. Again, technical progress in manufacturing had the tendency to reduce the volume of raw-materials input per unit of output. All these factors led to the continuously adverse terms of trade experienced by India. And as a result of the adverse changes in the terms of trade, the economic development of India was slowed down. It also restricted India's capacity to absorb foreign finance for developmental purposes. As a United Nations study has pointed out, 'The unfavourable long-term trend in the prices of primary materials relative to capital goods has ... limited the capacity of underdeveloped countries to absorb foreign financing for economic development...'[49] The cost that the Indian economy had to incur on account of the investment of foreign capital and the consequent adverse effects on terms of trade should be borne in mind when we make an assessment of the role played by foreign investments in India.

Looking at the pattern of economic changes in India initiated by foreign investments—an economic pattern specialising on raw materials and primary products—we can generally say that the net effect of foreign investments was to direct Indian initiative into fields of ecomonic activity providing less scope for technical advances.

The deterioration of the terms of trade of primary producing countries (in other words, the fall in the price ratio of primary products to manufactured goods), in the opinion of Raul Prebisch, means that the income of labour and the entrepreneurial class in the industrial countries increased more than productivity (otherwise there would have been a fall in prices as productivity rose) and the incomes in the primary producing countries have increased less than productivity. The fruits of technical progress, therefore, have gone mainly to the industrialised countries.[50]

The benefits of technical and industrial progress can be distributed either to the producers in the form of higher

49. United Nations, *Relative Prices of Exports and Imports of Underdeveloped Countries* (December, 1949) 16.
50. United Nations Economic Commission for Latin America, n. 47, 10.

profits and higher incomes or to the consumers in the form of lower prices. Singer has argued:

> In the case of manufactured commodities produced in more developed countries, the former method, i.e., distribution to producers through higher incomes, was much more important relatively to the second method, while the second method prevailed more in the case of food and raw-material production in the underdeveloped countries.[51]

It is difficult to test the validity of the above thesis in a very precise manner in the context of conditions in India. The causative relationship which Singer points out cannot be fully accepted in the case of India. The fall in prices of primary products in India, and for that matter even in other underdeveloped countries, was not the reflection of technical progress, but the result of superior pressure of foreign investors and traders which suppressed the prices of primary products.

Whatever be the reasons underlying this phenomenon, it is a generally accepted fact that in India, from the very beginning of the British period, the prices of raw materials and primary products not only fluctuated very often, but showed the tendency to register a fall over the period of years. The fall in the prices of primary products and raw-materials, while it was harmful to the Indian producers of these goods, was beneficial to the consumers, particularly in Britain. Thus Britain, as the consumer of India's raw-materials and primary products, gained substantially due to the low prices of these commodities. On the other hand, all the fruits of technical progress were concentrated in Britain through the accumulation of high profits by the British producers of manufactured goods. Thus Britain gained not only as the consumer of India's raw materials and primary products, but also as the producer of manufactured goods.[52]

51. Singer, n. 46, 478.
52. Singer points out that this pattern of colonial economic relations was evident in the case of other underdeveloped countries as well. He observed that 'This perhaps is the legitimate germ of truth in the charge

Let us consider the cumulative effects of all the changes that were brought to bear upon the indigenous economy by foreign investment in the British period. We have also to consider the effects of the structural changes on the standard of life of the people.

The destruction of indigenous industries resulted in an increase in unemployment and consequent reduction in income of a substantial section of the indigenous workers, weavers, craftsmen and other categories of workers. Apart from the decrease in income of the indigenous workers due to the disruption of their occupations, the income of employed workers was also depressed on account of the monopsonistic position of foreign investors in the Indian labour market. The downward pressure on the wages of Indian workers was only strengthened by the policies pursued by the British government in India. The workers who were thrown out of employment could not find re-employment since the scope for starting new industries was practically nil. A portion of the artisans and craftsmen who were displaced from their industries were absorbed in cultivation. But the major portion of the displaced workers remained unemployed because even the rural sector could not absorb additional population.

It is important to note that the proportion of the population in agriculture did not show any decrease during the British period. On the contrary, available statistics have revealed that there was a sudden increase in the agricultural population during the British period. During the period 1891 to 1921, while the total population in India increased by about 28.8 millions, agricultural population in India showed an increase of 55.3 millions. During the census period 1891-1901, a fresh territory with a population of about 24 millions was included in the census figures. This means that not only the net population of 24 millions, but also the natural increase of 28.8 millions in the total population in India were forced to rely upon land. In 1928,

that foreign investment of the traditional type formed part of a system of "economic imperialism" and of "exploitation"'. Singer, n. 46, 479-80.

about three-fourths of the population, or 229 millions out of a total population in India of 319 millions had their predominant interest in agriculture. The number of towns and cities with a population exceeding 100,000 each was 34. The total population in all these cities came to 8,053,123 or 2.5 per cent of the total population in India.[53]

If foreign investments had played an important role in starting the process of rapid industrialisation in India, it should have reflected itself in a shift in agricultural population from the agricultural sector to the industrial or urban sector.

From the above analysis, it can be observed that the structural changes in the economy in the British period were mainly in the direction of maintaining and strengthening the agricultural bias of the economy rather than in the direction of rapid industrialisation leading to a greater and greater proportion of the population engaged in industrial activities. A study of the changing pattern of the occupational distribution of the population in India during the British period, therefore, reveals the fact that foreign investments did not exert any significant impact on the Indian economy in the direction of industrial development in India.

The price that the Indian economy had to pay consisted not only of the destruction of the indigenous industries by the competitive power of British investments, but also in the 'opportunity cost' incurred in forgoing the natural process of domestic industrial development which would have taken place if the foreign investments were not there. In other words, we have to investigate into the cost of foreign capital investments to the indigenous economy from two angles. Firstly, we have to investigate whether indigenous entrepreneurial initiative and domestic investment were destroyed under the heavy impact of foreign investments or not. Secondly, using the concept of 'opportunity cost', we have to investigate whether the cost incurred in not allowing new domestic industries to grow was

53. Knowles, n. 22, 397.

greater than the possible benefits to the domestic economy by the existence of the foreign sector.

In the past, foreign investments, particularly of the type of 'colonial investments' showed a marked tendency to flow primarily into the export sector. This tendency has been justified by many authors on the ground that through the development of export industries by the foreign investors, India was offered all the advantages of international trade. This can be ascertained only from a study of the manner in which the export sector functioned in relation to the national sector catering for domestic consumption.

In the early period, foreign capital, mainly British, flowed in substantial amounts into tea, coffee, and rubber plantations, mines, etc. These industries mainly catered for the export needs. They were organised with the superior technical skill of the foreign investors and aided by capital intensive methods, as a result of which the productivity of the export sector was many times that of the domestic sector. The domestic sector with a primitive backbone and an organisation which was of a subsistence nature coexisted with the superior export sector.[54]

In the advanced countries, whose economies are internally integrated, productivity in the sector producing commodities for domestic consumption as well as for export, tends to be equal. Technical advance in one sector necessarily influence the other sectors and induces them to adopt similar technology, as a result of which productivity in the different sectors tends to move in unison. Such an equalisation of productivity which is true of the advanced countries does not, however, hold good in the case of India and other underdeveloped countries.

In India there had been lack of even a rough equivalence of productivity in the domestic and foreign sectors. The greater productivity of the export sector dominated by the foreign investors has not been diffused into the domestic

54. H. W. Singer points out that this was characteristic of all the underdeveloped countries which were under colonial rule (Singer, n. 46, 474).

sector. In other words, technical and industrial know-how of the foreign sector has not been readily made available to the domestic economy, as a result of which the productivity of the export sector has remained a multiple of the productivity in the domestic sector.

The dualistic nature of the economic structure, with a high productivity foreign (export) sector and a low productivity domestic sector was typical of the period of colonial investments. The high productivity of the export sector has been cited by some authors to substantiate their argument that foreign investments were beneficial to the recipient countries. They argue that foreign investments played a beneficial role in raising the general level of productivity in the recipient countries by spreading the knowledge of capital intensive methods and advanced technology.

The fact that the foreign (export) sector and the domestic sector remained aloof from one another without entering into a continuous process of integration tending to equalise the levels of productivity, proves that foreign investments in the export sector were not beneficial to the Indian economy in raising the general standard of productivity. The foreign-owned export sector did not become an integral part of the Indian economy. This was true of all the underdeveloped countries. As H. W. Singer observes:

> ...in many cases, the productive facilities for export from underdeveloped countries, which were so largely a result of foreign investment, never became a part of the internal economic structure of those underdeveloped countries, except in a purely geographical and physical sense.[55]

As a generalisation, we may say that, in the economic sense, the export sector in India was part of the investing country, namely, Britain, rather than a part of the Indian economy. Thus, the investment of foreign capital in the export sector in India was to the benefit of the investing country rather than to the recipient country. Again, since the results of foreign investments accrued to the investing country, the secondary multiplier effects of such investments took

55. *Ibid.*, 475.

place mainly in the investing country than in India where the investments were geographically or physically located. The concentration of the cumulative and multiplier effects in the investing country debarred India from enjoying one of the important benefits of investment.

We have already seen that during the British period, particularly after 1842-3, there was a continuous surplus of India's exports over her imports. This meant that there was a large outflow of resources on the capital account. This has been described as the 'drain' on India's resources suggesting that the foreign investment-cum-trade system imposed upon India by the British was causing a depletion in the domestic resources of India.

During the 41 years since 1842-3, the surplus of India's exports over imports averaged about 16 million per annum.[56] The export surplus existed in every single year during this period. L. H. Jenks who made an estimate of British capital in India during the period up to 1875 observed that the average export balance of merchandise from India, which was used for the transfer of investment income and the payment for administration from London, 'swelled' during the period from £4 million to between £15 and £20 million.[57]

For the period 1899-1900 to 1908-1909, Sir Theodore Morison made an estimate of the economic drain which came to an average of about £15 million per year.[58] This amount consisted of remittances abroad of interest on the loans borrowed for railways and irrigation work, etc., repayment of the capital borrowed, the payment for shipping services and the remittances for pensions of Englishmen who served in India. According to L.C.A. Knowles, the surplus payments during 1901-1902 amounted to a total of £16.88 million and it consisted of two main items, namely, interest

56. *Moral and Material Progress* (1873) 215. About this phenomenon, Wingate wrote that India paid Great Britain during the 19th century a heavy tribute of 'the almost incredible sum of [illegible] hundred millions sterling' (Wingate, *A Few Words on Our Financial Relations with India*, 7).

57. Jenks, n. 3, 225.

58. Sir Theodore Morison, *India in Transition*, 197.

and management of the debt £9.39 million, and pensions and gratuities £4.22 million.[59] As the rupee was depreciating over a period of years, more and more exports had to be sent abroad to fill the gap and adjust the gold payments abroad. This, obviously, increased the amount of drain on the Indian economy.

In 1913, the total profits reaped by the British investors from trading, manufacturing and shipping amounted to about £28 millions. Total profits on capital investments plus direct tribute (Home Charges) in the same year came to about £40 millions.[60] The accumulation of profits in the foreign sector assumed considerable proportions during the years of the First World War, 1914-19, and in subsequent years. According to Shah and Khambata, the annual drain from India in 1921-22 amounted to Rs 220 crores.[61] This meant that during the early decade of the present century Britain appropriated annually, under one title or the other, over 10 per cent of India's gross national income. For the year 1934, Sir M. Visvesvaraya estimated the figure of Rs 161 crores which excluded official remittances to England for pensions and other Home Charges, and liabilities to non-Britishers who had trade relations with India.[62] It is clear that a very large portion of the economic surplus of India was transferred to Great Britain on account of investment income payments and other charges

Reviewing the growth of foreign investments in India in the British period, it can be concluded that the cost incurred by India due to the transfer of profits and dividends abroad was much greater than what has been imagined by many writers. An evaluation of the total impact of foreign investments in the British period would reveal the fact that there was a net cost to the Indian economy on account of the investment of foreign capital in India.

59. Knowles, n. 22, 393.

60. R. Palme Dutt, *India Today and Tomorrow* (New Delhi, 1955) 55.

61. K. T. Shah and K. J. Khambata, *The Wealth and Taxable Capacity of India* (1924) 211-36.

62. Sir M. Visvesvaraya, *Planned Economy for India* (Bangalore, 1934) 178.

Chapter III

Growth of Private Foreign Investments Since Independence

A STUDY of the nature and magnitude of private foreign investments in India is basic not only to an understanding of India's international economic relations, but also to an assessment of the relative position of Indian industrial sector vis-a-vis the foreign sector. Changes in the sources of private foreign rapital and the forms in which they enter the country have immense relevance to any discussion on governmental policy towards foreign capital.

In tracing the trends in the growth of private foreign investments in India in the post-independence period, one has to rely almost entirely on the data provided by the Reserve Bank of India. There has been no other study as elaborate and systematic as the studies conducted by the Reserve Bank of India.

Many of the shortcomings of earlier estimates were due to the complex nature of the data itself.[1] There were companies incorporated abroad, doing business not only in India, but also in other countries. The accounts of these companies did not show the magnitude of capital investments in individual countries. Only aggregate figures for all the countries put together were made available. This posed the problem of making estimates of that part of the total

1. In the case of public debt owned abroad by government and semi-government agencies, there was no difficulty. Individual researchers had access to the published documents on the Finance and Revenue Accounts of the Central Government and also the Reports of the Municipalities and Port Trusts.

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capital of the Company which could be geographically apportioned to India.[2] The estimates of individual researchers and agencies diverged from one another significantly due to the divergence of the assumptions they made and the methods they applied in arriving at the estimates. Some of the estimates were, no doubt, good intelligent guesses.

The problem was further aggravated by the fact that there were companies incorporated in India, but actually working as subsidiaries of companies incorporated abroad, the character of which could not be easily detected by the documents published by these companies.[3] Thus valuable data about many such companies remained to be unearthed. In the case of companies whose share ownership pattern was a mixed one, that is, in which there were both foreign and Indian holdings, it was difficult to specify a certain percentage of foreign share capital which would enable the firm to be characterised as 'foreign'.[4] Clear demarcation being difficult, individual researchers had to adopt their own criteria according to convenience. On the top of all this, there was the glaring obstacle faced by all the private research agencies, namely, the unwillingness on the part of private industrialists to reveal the real nature of their operations, profit, etc., on the plea that they are business secrets. Only an institution like the Reserve Bank of India, armed with statutory powers to elicit detailed information from the foreign firms,[5] could undertake the task of preparing a

2. This problem is largely solved today because under the Companies Act, 1956, foreign companies with more than one branch (including the branch in India) have to submit their accounts in respect of their business in India alone. But in the case of foreign companies whose business is almost entirely confined to branches in India, the accounts of the parent companies, presented in the specified forms under Schedule VI of the Companies Act, 1956, are accepted by the government. In such cases, there may be a margin of error, however small it may be.

3. Contrary to what is generally believed, the words 'India Limited' do not provide us with an adequate indication for locating a foreign subsidiary company. Some foreign companies, while registering in India, do not stick these words on to the company's name.

4. This difficulty was pointed out by the Associated Chambers of Commerce in their Memorandum to the Simon Commission.

5. The Notification No. D.II.1869—EF/47, dated the 23 October 1947, issued by the Government of India, Ministry of Finance (empower-

reliable estimate of private foreign investments in India.

The Reserve Bank of India in their surveys on India's foreign liabilities and assets have used the term foreign capital to mean only the capital in India owned by non-residents. They accepted, without questioning, the suggestion made by the International Monetary Fund to adopt the Fund's definition of the term 'foreign obligations'. The request made by the International Monetary Fund to the Government of India stated:

> The distinction between foreign and domestic should be one of location rather than nationality. For instance, the branches or subsidiaries in your country of foreign institutions should be regarded as 'domestic' institutions having foreign liabilities or assets vis-a-vis the parent concern. Similarly a foreign branch of a domestic institution would be regarded as 'foreign'.[6]

In making a choice between the 'residence' criterion and the 'nationality' criterion, the Reserve Bank of India did not show the courage to renounce the limited 'balance of payments approach' of the International Monetary Fund. The limited scope of the Reserve Bank's surveys was, no doubt, prescribed in the Notification issued by the Government of India empowering the Bank to conduct the surveys. And the residence criterion was adopted in order to comply with the request of the International Monetary Fund. But the fact remains that the Reserve Bank overlooked the advantages of the 'nationality' criterion.

According to the residence criterion, the assets of foreign nationals resident in India are not considered as foreign

ing the Reserve Bank of India to call for necessary information for the purpose of the census of foreign investments) stated that '...in pursuance of Sub-section (1) of Section 4 of the International Monetary Fund and Bank Ordinance, 1945 (XLVII of 1945), the Government of India is pleased to authorise the Reserve Bank of India to make orders under the said sub-section requiring any person to furnish to such officer or other person as may be specified in the order such detailed information as the Reserve Bank may determine to be essential for the purpose of complying with the request of the International Monetary Fund' (Quoted in Reserve Bank of India, *Report on the Census of India's Foreign Liabilities and Assets as on 30 June 1948*, 8).

6. *Ibid.*, 7.

liabilities of India or foreign assets in India. The assets outside India of foreign nationals, according to this criterion, are regarded as Indian assets abroad. This involves, obviously, an attempt to stretch the meaning of the terms foreign assets and liabilities. The Economic Advisor to the Reserve Bank of India himself admitted that 'This may appear somewhat odd'...[7] But at the same time the Reserve Bank has tried to justify this criterion by saying '...it conforms to the accepted practice of similar investigations in other countries whch has as their object the analysis of factors bearing upon the current international payments position on the country.[8]

The data on India's foreign investment position was collected by the Reserve Bank of India essentially with the purpose of improving the compilation of balance of payments data rather than for the purpose of measuring the costs and benefits of foreign investments or to assess their role in the economic devlopment of India. As the Reserve Bank has admitted, they relied on the residence criterion on the ground that the information based on such criterion is 'more germaine to and of primary importance for balance of payments purposes'.[9] The preoccupation of the Reserve Bank of India with the task of improving the balance of payments data debarred it from employing the nationality criterion.

The residence criterion adopted by the Reserve Bank of India may be in line with the denotation of the word 'foreign' used in the Indian income-tax laws. But it is definitely defective because it excludes the capital owned by foreign nationals who are residents in India. The foreign nationals who are residents today are 'potential non-residents' of tomorrow.[10] In this sense, it will be better to use the word

7. *Ibid.*, Prefatory Note to the report by Dr B. K. Madan, 10.
8. *Ibid.*, 10.
9. *Ibid.*, 10.
10. According to an estimate made by the Reserve Bank, the total repatriation of private long-term capital from India between the end of June 1948 and end of 1953 amounted to about Rs. 60 to Rs. 65 crores. Out of this, Rs. 10 to Rs. 15 crores were the repatriation of proceeds from shares and debentures of foreign nationals who were till then residents

'foreign' to include all foreign nationals both residents and non-residents.

As pointed out earlier, the surveys conducted by the Reserve Bank were in response to a request made by the International Monetary Fund to member-countries to provide information relating to their international payments and investment position.[11] Prior to the 1948 census of India's foreign liabilities and assets, foreign investment position of the country was gauged largely with the help of the balance of payments data. The inadequacy of the balance of payments data in giving a correct picture of the international investment position of a country arises from the fact that foreign capital movements in the form of cash receipts and payments only are recorded in the balance of payments statistics. The records of the Exchange Control Department, on the basis of which the balance of payments data are organised, reveal only those economic transactions which give rise to receipts or payment of foreign exchange. Actually, foreign investments grow not only through the inflow of cash from abroad, but also through investments in kind[12] and the ploughing back of profits.[13]

It cannot be overemphasised that, in order to place the present status of foreign investments in India in a historical perspective, their growth over the years will have

in India, but migrating from India to their home countries. Such transfers are really in the nature of repatriation of private foreign capital. But under the residence criterion, the Reserve Bank considers it as 'migrants' transfers' and not as repatriation of private foreign capital. Thus the use of the residence criterion leads to an underestimation of the actual repatriation of private foreign capital.

11. Extracts from the request of the International Monetary Fund, *ibid.*, 7-8.

12. For example, companies abroad may increase their investments in India by sending plant and equipment to their branches in India. This may not involve any payment on the part of the branches in terms of foreign exchange, and thus, the resulting increase in foreign investments will escape the notice of the Exchange Control Department.

13. This has been an important method by which a number of foreign concerns have managed to increase their capital stock in India. This is a form of 'capital inflow' which does not involve the receipt of foreign exchange. Thus, it remains outside the purview of balance of payments statistics.

to be carefully studied.[14] Such a study of the trends in the growth of foreign capital has to be based on both countrywise and industrywise classifications. In the following pages a detailed analysis of the existing data relating to private foreign investments[15] is attempted with a view to focus attention on some of the major trends in foreign capital inflow into India.

Contrary to the fears expressed by many on the eve of Indian independence and in the period immediately following independence, the Reserve Bank of India studies have clearly established the tendency of private foreign firms in India to grow not only by fresh inflow from abroad, but also by investments in kind and by the domestic diversion of funds.

The continuously increasing volume of foreign capital in India clearly refuted the assertion made by many persons in India that after the transfer of political power in August 1947, private foreign capital had gone 'shy'. The first study made by the Reserve Bank of India itself had exploded this myth. The subsequent studies only disproved, beyond doubt, the prophesies of many that the political changes in India in 1947 would have an adverse effect on foreign capital inflow in the long run.

The figures given in the Reserve Bank of India studies, however, do not help to prove or to disprove the assertion that immediately after independence and consequent upon

14. The figures for private foreign investments in the following study do not include foreign investments in the banking sector of a short-term nature.

15. The major sources of data on private foreign investments in India are the studies conducted by the Reserve Bank of India, namely:

(i) *Report on the Census of India's Foreign Liabilities and Assets as on 30 June 1948;*

(ii) *Report on the Survey of India's Foreign Liabilities and Assets as on 31 December 1953;*

(iii) *Report on the Survey of India's Foreign Liabilities and Assets as on 31 December 1955;*

(iv) The annual studies made by the Reserve Bank of India appearing in *Reserve Bank of India Bulletin,* September 1958; June 1959; April 1960; and May 1961.

The data provided by the Reserve Bank of India has been supplemented by the data from other sources.

the changed political climate there was a short-term tendency on the part of foreign capital for self-liquidation. In order to arrive at the truth we have to examine India's foreign capital account from August 1947 itself. But the Reserve Bank studies provide us with figures of foreign capital from July 1948 only, and therefore, they cannot throw light on what happened in the first year of Indian independence.

No doubt, there was a certain degree of disinvestment in the foreign sector in the few years after independence. Disinvestment was particularly true in the case of British investments.[16] According to an estimate during the period up to 1951, British capital accounted for Rs. 42.6 crores out of a total disinvestment of Rs. 58.6 crores.[17] It seems that disinvestment had started at the end of the war in 1945, but it subsided after reaching its peak in 1949. Between 1947 and 1952, about 66 foreign concerns were bought over by Indians. Out of this, 64 were British concerns.[18] The amount of disinvestment during the period 15 July 1948 to March 1953 in certain sectors has been put at the following order by an estimate.

Table 4

	Rs. crores
Utilities (supply of electricity)	5.03
Managing agencies	5.31
Plantations	2.66
Manufacturing industries (cotton textiles, chemical goods, confectionery, rubber, etc.)	1.17
Mining	0.15

Source: *Capital* (Calcutta), 3 September 1953, 321.

According to the estimate made by the Reserve Bank of

16. In the case of British investments, repatriation was significant in jute, tea and coal where some of the old agency companies sold out their interests. Some of the agency companies which remitted their capital abroad were McLeod and Co., Kettlewell and Bullen, Duncan Bros., Macneill and Berry, and Forbes Campbell (See H. T. Parekh, *The Future of Joint-Stock Enterprise in India* (Bombay 1958) 128.

17. Turtle and Malcolm, *Report on Recent Visit to India,* quoted in D. K. Rangnekar, *Poverty and Capital Development in India,* 119-120.

18. *The Eastern Economist* (New Delhi) 21 November 1952, 849.

India, the repatriation by non-residents during 1948-53 was about Rs. 50 crores.[19] Transfer of ownership from foreign to Indian hands continued during 1954 and 1955 also, and in many cases the transfer was effected at highly inflated prices and through cornering of shares.[20]

While disinvestment was taking place in the above manner and magnitude, the rate of capital inflow was at a comparatively low level. The volume of British capital invested in India during July 1948 to June 1950 was only about Rs. 6.34 crores.[21] Even though the number of new foreign firms which were granted permission to set up industrial undertakings in India showed an increase during 1948-50 from 24 in 1948 to 44 in 1949 and 47 in 1950,[22] the new investments amounted to only Rs. 5.3 crores, Rs. 6.3 crores and Rs. 3.3 crores respectively as can be seen from table 5.

Table 5

NEW INVESTMENTS OF FOREIGN CAPITAL IN INDIA, 1948-51
(Rs. lakhs)

Countries	*1948*	*1949*	*1950*	*1951*
United Kingdom	466.35	596.67	225.75	1160.45
United States	—	6.16	11.75	304.05
France	—	12.00	9.10	2.50
Switzerland	—	—	47.75	21.95
Sweden	60.00	5.00	—	0.30
Austria	—	—	—	14.00
Pakistan	—	—	25.00	—
Other countries	1.60	14.78	15.42	1.30
Total	527.95	634.61	334.77	1504.55

Source: Statement laid on the table of the House by the Minister of Commerce and Industry on June, 1952.

From the figures in table 5, it is clear that up to 1950, foreign capital inflow was at comparatively low rate of

19. Reserve Bank of India, n. 15-iii.
20. 'Active Stock and New Issue Market,' *Economic Weekly* (Bombay) Annual Number, 1955.
21. *The Eastern Economist* (New Delhi) 29 September 1950.
22. Reply to question in Parliament by the Deputy Minister of Commerce and Industry on 20 March 1951, *Parliamentary Debates*, Pt. I, vol. VI, No. 32, 2435.

about Rs. 3 to 6 crores annually. There was a sudden jump in the capital inflow in 1951 to about Rs. 15 crores. Along with these facts, if we take into account the amount of disinvestment that took place during 1947-50, the possibility that at least a portion of foreign capital might have been scared away from India during a short period after 1947 as a result of the political changes in that year, cannot be ruled out. Capital inflow from abroad started on a significant scale only after 1950. Taking the entire period July 1948 to 1953, there was a significant increase in foreign investments.

Even though there is a strong presumption that during the few years following the political changes of 1947, foreign capital was scared away to a certain extent, taking the entire period since independence, foreign private capital has been increasing more or less at the same rate as it did in the British period.[23] Suffice it to show that the disinvestment that took place in the private foreign companies before and after independence was not significant enough to reduce the total volume of outstanding private foreign investments in India. In other words, the myth of foreign capital's 'shyness' after Indian independence stands completely exposed.

A detailed study of the growth of private foreign investments in India during the period 1947-60 reveals many interesting trends. While the total private foreign investments showed an increasing trend, there were variations in the growth of investments in different sectors of the economy. The inflow of capital from the various creditor countries also revealed wide variations.

The figures in table 6 below reveal the predominant position held by the United Kingdom. British private investments in India increased from about Rs. 206 crores at the middle of 1948 to about Rs. 393 crores at the end of 1956 and to nearly Rs. 442 crores at the end of 1960. In other

23. At the beginning of the present century, capital from the United Kingdom used to be invested in India at the rate of about Rs. 20 crores annually. Foreign capital increase in India during 1948-57 at an average rate of Rs. 20.7 crores per annum (after making adjustments for valuation changes) compares well with the rate of increase in the British period.

Table 6

PRIVATE FOREIGN INVESTMENTS IN INDIA, 1948-60
(Rs. crores)

	As at the end of							
	June 1948	*1953*	*1955*	*1956*	*1957*	*1958*	*1959*	*1960*
United Kingdom	206.0	326.4	376.8	392.5	398.8	398.8	398.9	441.6
	(80.5)	(83.3)	(83.1)	(82.1)	(80.4)	(79.7)	(78.0)	(78.0)
United States	11.2	30.1	39.9	47.0	57.5	60.0	67.6	72.6
	(4.4)	(7.7)	(8.8)	(9.8)	(11.6)	(12.0)	(13.2)	(12.8)
Switzerland	5.4	6.0	6.6	8.2	6.7	6.8	7.6	8.9
West Germany	0.1	0.1	2.5	2.8	3.5	3.8	5.4	6.8
Japan	0.2	0.1	0.2	0.2	0.6	0.6	0.6	1.4
Pakistan	8.4	4.1	4.4	4.2	4.2	4.2	4.2	4.2
Other countries	24.6	25.3	23.1	23.2	24.8	26.2	26.8	30.9
Total	255.8	392.0	453.4	478.2	496.1	500.4	511.5	566.4

Sources: *Reserve Bank of India Bulletin* (April 1960) 477; (May 1961) 685; (October 1962) 1542. *Note*: Resources from the IBRD and other official agencies such as the Export-Import Bank and the Development Loan Fund invested in private business in India are omitted here. Figures in brackets show the percentage share of the investing country in the total private foreign investments in India in the various years.

words, British private investments in India more than doubled during a period of over twelve years. At the end of June 1948 British investments in India accounted for about 80.5 per cent of total private foreign investments in India. The percentage share of British investments increased to 83.7 per cent by the end of 1953. The percentage share of the United Kingdom decreased continuously afterwards becoming 82.1 per cent in 1956 and 78 per cent in 1959 and 1960. In other words, while Britain still maintains the predominant share of private foreign investments in India, in relative terms British investments have been generally loosing ground.

American private investments in India, on the other hand, show an increasing trend not only in absolute terms but also in relative terms. United States has been the second major creditor of India in the private foreign investment account. American investments in India, although still con-

stituting only a minor share of the total private foreign investments in India, recorded a rapid rate of increase during the post-independence period. Private investments from the United States stood at a very low figure of Rs. 11.2 crores at the end of June 1948. But by the end of 1956 American investments had grown by about fourfold, reaching a total of Rs. 47 crores. This significant rate of growth was maintained during the Second Plan period and by the end of 1960 total American investments stood at Rs. 72.6 crores. In terms of the percentage share in total private foreign investments in India, the United States increased their position from 4.4 per cent in June 1948 to 9.8 per cent in 1956 and to 13.2 per cent in 1959. The percentage share at the end of 1960, however, showed a slight decline to 12.8 per cent.

Other countries which have private capital holdings in India are Switzerland, West Germany, Japan and Pakistan. Swiss private investments in India showed fluctuations during the post-independence period. From Rs. 5.4 crores at the end of June 1948, it increased to Rs. 8.2 crores in 1956; but it declined in the following year to Rs. 6.7 crores to be followed by another period of slow increase. Thus by the end 1960, private investments from Switzerland stood at Rs. 8.9 crores. In the case of West Germany there was an impressive start from a very low initial level of just about Rs. 10 lakhs in June 1948 to Rs. 6.8 crores by the end of 1960.

We have seen how the book-value of foreign investments of the various creditor countries varied over the period 1948-60. These figures, however, do not correctly represent the net movement of foreign capital into India because during this period valuation changes occurred in some sectors.

The balance-sheet values of both fixed and floating assets may be affected by valuation changes. As regards floating assets, the Reserve Bank of India, in their report on the survey of India's foreign liabilities and assets,* holds the view that the possible valuation changes of floating assets,

particularly between 1953 and 1955, were insignificant.[24] In support of this contention, the Report states that only in periods of substantial price movements valuation changes of floating assets take place to any significant extent. The period 1953-5 witnessed relative stability in the price level particularly of raw materials and manufactured goods, and since precisely these goods constitute the bulk of the floating assets of business concerns, the Report argues, the valuation changes in respect of floating assets must have been insignificant.

In the case of fixed assets, on the other hand, the Reserve Bank estimated the total valuation changes during 1948-53 to be about Rs. 15 crores. For the period 1954 and 1955, the original estimate of the Reserve Bank placed it at Rs. 22 crores. Out of this, the major portion amounting to Rs. 20 crores was in respect of tea plantations. Foreign investments in other sectors were written up through revaluation only to a small extent of Rs. 2 crores.[25] In the subsequent studies, however, the Reserve Bank has revised these figures. According to the revised estimates, during 1954 and 1955 total revaluation is now taken to have been of the order of Rs. 32 crores.[26] Even though the Reserve Bank studies do not give the magnitude of revaluation in individual sectors, it may be safely assumed that this phenomenon was concentrated mainly in plantations. In 1958 and 1960 the total revaluation in the private foreign sector was only Rs. 2 crores, and Rs. 1.6 crores respectively.

Revaluation of fixed assets is usually resorted to only if the current replacement value of the assets varies significantly from the book value of these assets. Ordinarily, such a significant variation between replacement values and book values of the fixed assets occurs only at fairly long

24. Reserve Bank of India, n. 15-iii, 17.

25. *Ibid.*, 18.

26. Reserve Bank of India, in its later surveys does not specifically mention the change in their estimates of revaluation; but the difference of Rs. 32 crores between the estimates of increase in private foreign investments and the estimate of net inflow during 1954 and 1955 can only be attributed to valuation changes.

intervals. It seems, however, that the primary compulsion for revaluation in the foreign sector has been the desire of the foreign investors to inflate the book values so that they may earn a larger value when sold out to Indian hands or to claim higher compensation in the event of future nationalisation. This presumption is strengthened by the fact that revaluation was resorted to on a massive scale only in plantations where the foreign investors have, for a long time, shown a tendency to sell out their interests whenever attractive prices are offered.

After making the necessary adjustments for valuation changes during 1948-53 and during 1954 and 1955, the net inflow of foreign capital into India during 1948-60 has been as follows:

Table 7

NET INFLOW OF PRIVATE FOREIGN CAPITAL INTO INDIA, 1948-60

(Rs. crores)

July 1948 to December 1953 (annual average)	22.7
1954 and 1955 (annual average)	14.9
1956	24.9
1957	17.8
1958	2.4
1959	11.0
1960	53.3

Sources: (i) *Reserve Bank of India Bulletin* (June 1959) 660; (ii) *Ibid.* (May 1961) 676; (iii) *Ibid.* (October 1962) 1532.

The net inflow of private capital during 1948-60 showed a continuously changing pattern. Capital inflow (net) during 1948-53 was at an average rate of Rs. 22 crores per annum. It declined to Rs. 14.9 crores in 1954 and 1955. In 1956 it reached the peak with an annual rate of inflow of Rs. 24.9 crores. The subsequent period, however, showed a definite decline.

Taking the entire period 1948-60, we get an average rate of inflow of foreign capital of the order of Rs. 20.8 crores per annum.

The figures for net capital inflow from abroad, as shown

in the preceding table do not represent the net addition to foreign exchange resources we have mobilised from private foreign investors. Only a portion of this 'capital inflow' actually represent the inward cash movements from abroad. A significantly large percentage of the capital inflow is made up of ploughed-back profits in the foreign companies in India and of investments in kind. If we study the pattern of private capital inflow into India, it will be seen that there are three forms in which private foreign capital is accumulated in enterprises in India. They are (i) inward cash transfers, (ii) investments in kind, and (iii) reinvestments of profits.

The Reserve Bank studies show that during July 1948 to December 1953 there was an average annual net outflow of funds amounting to Rs. 3.1 crores. During the same period, repatriation of foreign capital was of the order of Rs. 50 crores or an annual rate of Rs. 9.1 crores. The gross inflow of foreign funds during 1948-53 was, therefore, Rs. 6 crores per annum. During 1954 and 1955, about Rs. 10 crores of foreign capital was repatriated from India (excluding transfers abroad of accumulated profits).[27] It is important to note that since 1956, transfers abroad of accumulated profits is treated by the Reserve Bank of India as capital repatriation. Such remittances of accumulated profits during 1954-55, according to the Reserve Bank, came to Rs. 22 crores. It is, therefore, appropriate to include this in gross capital transfers, thus making a grand total for 1954 and 1955 of Rs. 32 crores or Rs. 16 crores per year on the average.[28] Against this amount of outward cash transfers, inward cash transfers for investment purposes took place only to the extent of Rs. 3 crores or Rs. 1.5 crores annually. Thus, there was a net outflow of funds to the tune of Rs. 29 crores during 1954 and 1955 or Rs. 14.5 crores annually.

Net outflow of funds amounted to Rs. 3.2 crores in 1956 and 1957. By far the most significant outflow of funds took

27. Reserve Bank of India, n. 15-iii, 18.

28. Since the amount of Rs. 22 crores of accumulated profits is treated in the following discussion as an item of capital transfers, the same amount is added in the figure of reinvestments of profits as an offsetting item.

place in 1958. The gross outflow of Rs. 24.4 crores was only partially offset by the inflow of Rs. 4.8 crores, thus creating a net outflow of funds to the tune of Rs. 19.6 crores. The net outflow of funds in 1959, amounting to Rs. 11.5 crores, though smaller than the net outflow in 1958, was considerably larger than the net outflows during 1948-57. In 1960, while the gross inflow was greater than in the previous years, the volume of repatriation was relatively low, thus resulting in a net outflow of only Rs. 2.9 crores.

Thus India witnessed the paradox of a continuously increasing volume of private foreign capital coexisting with a net outflow of funds every year on the private foreign capital account. The following table gives a picture of the outward and inward movements of funds on private foreign capital (long-term) account.

Table 8

FLOW OF PRIVATE FOREIGN CAPITAL (CASH TRANSFERS ONLY) DURING 1948-59

(Rs. crores)

Period	*Gross inward cash transfers*	*Repatriation of foreign capital**	*Net cash transfers (inward flow +, outward flow −)*
July 1948 to December 1953 (annual average)	6.0	9.1	− 3.1
1954 and 1955 (annual average)	1.5	16.0	−14.5
1956	3.1	6.3	− 3.2
1957	5.9	9.1	− 3.2
1958	4.8	24.4	−19.6
1959	3.3	14.8	−11.5
1960	6.2	9.1	− 2.9

Sources: (i) Reserve Bank of India, *Report on the Survey of India's Foreign Liabilities and Assets as on 31 December 1955,* 18; (ii) *Reserve Bank of India Bulletin* (June 1959) 660; (iii) *Ibid.* (May 1961) 676; (iv) *Ibid.* (October 1962) 1532.

* This excludes transfer abroad of accumulated profits.

It is clear from the above table that, in terms of foreign exchange resources, the contribution of private foreign investments has been negative. During the period 1948-60, against the average annual gross inflow of funds at the

rate of Rs. 4.7 crores, repatriation took place at the rate of Rs. 11.7 crores. Thus there was a net outflow of funds on private foreign capital account at an average rate of Rs. 7.2 crores per annum. It means that even though private foreign investments in India grew at the rate of Rs. 21.8 crores per annum during the period 1948-60 in terms of foreign exchange resources there was an actual outflow of Rs. 7 crores on the average every year.[29]

The variations in the volume of capital repatriation as seen from the above table do not really indicate any symptom of capital flight. The comparatively large outflow during 1948-53 and also during 1957-59 can be explained by special circumstances. No doubt, it is possible to argue that the capital outflow during 1948-53 was affected by the uncertainties posed by the political changes in 1947. And the actual repatriation of capital was, probably, much larger than the Rs. 50 crores during 1948-53 given in the Reserve Bank surveys, because their estimates for that period treated remittances abroad of 'accumulated profits' as transfer of investment income and not as capital repatriation. Capital repatriation in 1957 was largely the result of compensation payments paid to Life Insurance Companies. A sum of Rs. 4.8 crores was paid in the form of compensation in 1956 following the nationalisation of these companies. Again, the considerably high volume of repatriation in 1958 and 1959 was particularly due to capital transfers from the petroleum industry. Petroleum alone accounted for Rs. 21.9 crores and Rs. 12.9 crores of capital repatriation in 1958 and 1959 respectively.[30]

The information contained in the surveys published by the Reserve Bank of India regarding investments in kind up to 1956 are only derived estimates. The Reserve Bank

29. This was nothing peculiar to India. Most of the underdeveloped countries have witnessed the curious phenomenon of a net outflow of funds on private capital account in the postwar years. A study by the United Nations on the international flow of private capital observes that this phenomenon has been true in the case of India, Ceylon, Indonesia and Egypt (UAR). See United Nations, *International Flow of Private Capital, 1946-52* (New York, 1954) 6.

30. *RBI Bulletin* (May 1961).

made estimates of cash transfers (inward and outward) and also of net accumulation of profits in the firms. The total of these two forms of capital inflow was deducted from the estimates of the increase in private foreign investments corrected for valuation changes. The difference was taken to be the volume of foreign investments in kind. From 1956 onwards the Reserve Bank of India has been collecting information directly from the foreign companies concerned about investments in kind.[31]

The growth of private foreign capital has been mainly based on reinvestments of profits[32] and investments in kind. Reinvestments in the foreign sector in India took place at an average rate of Rs. 12.7 crores during 1948-53. Ploughed-back profits constituted a very considerable portion of the total increase in foreign capital in 1954 and 1955, accounting for Rs. 23 crores per year on the average. About Rs. 19.5 crores were ploughed back in the foreign enterprises in India in 1956. Reinvestments in 1957 and 1958 were lower at the rate of Rs. 9.5 crores and Rs. 9.8 crores respectively. The amount was substantial in the following years, 1959 and 1960, amounting to Rs. 15.3 crores and Rs. 14.5 crores respectively. The following table gives the pattern of private foreign capital inflow into India during 1948-60. It is important to note that the unprecedented increase of Rs. 53.3 crores of private foreign capital in 1960 was largely due to a very substantial inflow of Rs. 41.8 crores of investments in kind.

31. Reserve Bank of India, n. 15-iii, 18.

32. Private (direct) foreign investments all over the world have shown an increasing tendency in the post-war period to grow through reinvestments of profits. As a United Nations' report observed, 'The additions to outstanding private business investments appear to have been financed through reinvestment of undistributed profits by as much as three-fourths or more' (United Nations, n. 29, 6).

Growth through reinvestments has been on a considerable scale in the case of United States private investments abroad. For example, in the OEEC countries about 68 per cent of the increase in the book-value of United States direct investments during 1948-51 was the result of ploughing-back of profits (See John H. Dunning, *American Investments in British Manufacturing Industry*, London, 1958, 287).

Table 9

PATTERNS OF PRIVATE CAPITAL INFLOW INTO INDIA, 1948-60

(Rs. crores)

Years	*Cash transfers (net)*	*Reinvestments of earnings*	*Investments in kind*	*Net inflow of capital*
July 1948 to December 1953 (annual average)	− 3.1	12.7	12.4	22.0
1954 and 1955 (annual average)	−14.5	23.0	6.4	14.9
1956	− 3.2	19.5	8.5	24.9
1957	− 3.2	9.5	11.4	17.8
1958	−19.6	9.8	12.3	2.4
1959	−11.5	15.1	7.2	11.0
1960	− 2.9	14.5	41.8	53.3

Sources: (i) *RBI Bulletin* (June 1959) 660; (ii) *Ibid.* (May 1961) 676; (iii) *Ibid.* (October 1962) 1532.

The predominance of non-cash investments in the total gross increase in foreign investments in India is, probably, one of the less known facts about foreign capital in India[33] Such non-cash inflow accounted for about 85 per cent of the gross inflow of foreign capital during 1948-60. On the other hand, net increases in cash transfers, that is, after deducting the volume of repatriation, the cash transfers were negative during the entire period, 1948-60.

The reasons for the predominance of non-cash forms of foreign investment, in general, are to be found in the various factors which have collectively determined the low rate of international private investments in the postwar period. Probably, this may also be a reflection of certain aspects of strategy applied by foreign concerns. For instance, in a country where national sentiments are strong, foreign concerns may consider it bitter not to have cash investments because cash investments are an obvious form of investment, thus arousing antagonistic national feelings.

It will be worth while to examine the difference in the

33. Failure to appreciate this fact is often reflected in arguments in favour of private foreign capital based on its so-called 'contribution in solving our foreign exchange problem.'

rate of growth of the private foreign investments from the two major creditor countries of India, the United States and the United Kingdom. As we have already noted, while British investments in India more than doubled during 1948-60, American investments increased about 6 times during the same period. The two countries, the United Kingdom and the United States, together have contributed practically the entire increase in private foreign investments in India over the period, new investments from other countries being negligible. It should be noted, however, that from 1959 on countries other than United Kingdom and the United States have begun to make themselves felt in the field of private capital in India by contributing a small but slowly increasing volume of capital. Net inflow from these countries which stood at a paltry figure of Rs. 1.8 crores increased to 3.3 crores in 1959 and to Rs. 5.6 crores in 1960.

Table 10

ANNUAL INFLOW OF BRITISH AND AMERICAN PRIVATE CAPITAL INTO INDIA, 1948-60

(Rs. crores)

Years	*UK*	*USA*	*Other countries*	*All foreign countries*
July 1948 to December 1953 (annual average)	19.2	3.4	−0.6	22.0
1954 and 1955 (annual average)	9.9	4.9	0.1	14.9
1956	15.7	7.3	1.9	24.9
1957	6.3	10.5	1.1	17.9
1958	−2.0	2.6	1.8	2.4
1959	0.1	7.6	3.3	11.0
1960	42.7	5.0	5.6	53.3

The rate of British capital inflow was generally on the decline up to 1959 while, on the whole, the performance of the United States evidenced an upward trend. In the three years from 1957 to 1959 inflow of American investments surpassed that from the United Kingdom. The net outflow of British capital amounting to Rs. 2 crores in 1958 and the

unprecedented inflow of British capital to the tune of Rs. 42.7 crores in 1960 have to be explained largely by abnormal flows from and to the British petroleum companies in India. In part, the massive inflow of British capital in 1960 may be a reflection of the conscious attempt on the part of British monopoly interests to regain some of the ground they had lost to their American counterparts.

The increasing role of the United States in the supply of private foreign capital to India is what is to be expected in the light of trends in the movement of international private capital after World War II. Before World War I, the United Kingdom was the centre of international private capital and London acted as the 'World's Banker'. British overseas investments accounted for about 7 per cent of the United Kingdom's national income. In 1914 British investments abroad were of the order of 18 billion dollars which was about 5 times the American investments abroad in the same year.[34] But by 1945, while the United Kingdom witnessed a net decrease in her overseas investments, the United States 'experienced almost a virtual monopoly of private overseas investment'.[35]

The replacement of the United Kingdom by the United States as the main source of international private capital is, no doubt, one of the most significant developments in international economic relationships during the last 45 years and particularly after the two world wars. In the case of India, however, this phenomenon showed considerable time-lag and was clearly reflected in the figures of foreign capital inflow into India only in 1957, even though the race for supremacy had started as early as 1953.

The fact that such a development is not viewed by British private industrialists with satisfaction was reflected in the speeches made by Sir Norman Kipping, the Director-General of the Federation of British Industries during his visit to India. He referred to the determination on the part

34. A. K. Cairncross, *Studies in Home and Foreign Investment, 1870-1913* (Cambridge, 1953) 4.
35. Dunning, n. 32, 286.

of British investors to 'increase the lead' which Britain enjoys today in respect of the volume of outstanding investments in India. Present indications are that British investors will try to regain their lost grounds from American investors and atleast match the US efforts in the field of international private investments. And the massive British Petroleum investments in 1960 may well be part of this over-all strategy.

One need not doubt the ability of British industry to stage a come-back. This belief is strengthened by the fact that the economy of the United Kingdom has recently attained a higher level of production than was anticipated. Moreover, the British government has been trying, with concerted efforts, to contain the influence of the United States in the underdeveloped world, particularly in the former dependencies of the United Kingdom. But such a come-back cannot materialise without the help of other countries in Western Europe. The success of such an efforts, in the ultimate analysis, will also depend upon the response of Indian industrialists and the Government of India towards Indo-British collaboration. The choice of Indian industrialists with regard to technology, whether it should be British or American will be an important factor. In other words, the prospects of the United Kingdom stepping up its investments in India substantially in the coming years depends not only on the determination of the British industrialists but also upon the willingness of the Indian industrialists to undertake business on lines similar to British technology so that collaboration becomes feasible. If evidences so far available in this respect are a guide, it is likely that Indian industrialists will look more and more towards American enterprise rather than the British for future Indo-foreign collaboration.

A detailed study of the trends in the growth of foreign investments in India in the main sectors of business activity is required for detecting the direction in which foreign private capital has been flowing. The magnitude of foreign private investments in the various sectors of economic activity such as manufacturing, trading, utilities, mining,

plantations, etc., during the period 1948-60 were of the following order:

Table 11

GROWTH OF FOREIGN PRIVATE INVESTMENTS IN INDIA, 1948-60

(Rs. crores)

Business sectors	*As at the end of* June 1948	1953	1955	1956	1957	1958	1959	1956
Petroleum	22.3	77.1	104.0	116.4	134.1	118.4	119.5	149.2
Manufacturing	70.7	124.1	129.1	132.8	137.1	146.4	165.3	184.3
Trading	43.0	27.7	27.1	29.3	27.4	30.0	28.3	30.2
Plantations	52.2	71.5	87.2	87.9	86.6	96.0	95.1	99.5
Utilities and transport	31.5	40.8	42.7	48.9	52.6	50.0	42.2	42.1
Mining	11.5	8.4	9.6	10.8	9.8	12.4	13.0	13.3
Financial	6.9	14.7	27.8	27.5	24.2	22.9	23.0	22.4
Miscellaneous	17.7	27.7	25.9	24.6	24.4	24.3	25.0	25.3
Total	255.8	392.1	453.4	478.2	496.1	500.4	511.5	566.4

Sources: *RBI Bulletin* (April 1960) 476; *Ibid.* (May 1961) 684; and *Ibid.* (October 1962) 1540. *Note*: Resources from official sources abroad invested in the private sector in India have been omitted.

The increase in foreign capital in plantations from Rs. 52.2 crores in June 1948 to Rs. 99.5 crores in 1960, as seen from the above table, do not actually represent net additions to foreign capital because during this period revaluation of assets to the tune of over Rs. 42 crores took place in the plantation companies. Making allowance for valuation changes, it will be seen that the net addition of foreign capital was insignificant in the plantation sector. The position in sectors such as trading (excluding petroleum trading), mining, and utilities and transport was more or less stagnant during the period 1948-60.

The largest volume of private foreign investments has been in the manufacturing sector during the period 1948-60. Foreign investments in manufacturing industries increased from about Rs. 71 crores in June 1948 to about Rs. 184 crores in 1960. However, the increase in petroleum investments

was, in a sense, more significant. Foreign investments in petroleum companies which stood at Rs. 23.2 crores in June 1948 multiplied itself by about six, reaching the level of Rs. 149 crores by the end of 1960.

The increasing importance of the manufacturing sector which caters largely to the domestic market, introduces a new element in the nature and pattern of private foreign investments. One of the special characteristics of the foreign sector in India from the early years has been the tendency to concentrate in the export sector. This traditional pattern, in which foreign business was primarily export-oriented, was due to a number of factors. Firstly, the foreign firms in India which were either subsidiaries of parent companies abroad or branches of companies incorporated abroad had intimate connections with export market. The world-wide trade connections of the parent companies were directly utilised to the advantage of the subsidiary companies and branch firms. The already established export outlets of the parent companies gave a definite superior advantage to the foreign firms in India compared to the Indian firms. The growth of monopoly power in the foreign sector and the organisation of industrial and trade associations among foreign companies further strengthened the power of foreign firms to keep off Indian industries from a considerable portion of India's export trade. Secondly, the products in which foreign investors came to specialise in India were mostly those which could command an increasing demand in the world market. Thirdly, the foreign firms conducted product specialisation to such an extent that it was difficult for Indian industrialists to cut across the consumers' preferences artificially created by the foreign firms.

All the above factors which were operative in the British period began to lose their importance in the changed conditions after independence. The growth of the Indian industrial class, the strengthening of their relative position vis-a-vis the foreign sector, and the favourable effects of developmental planning on the consolidation of Indian bourgeosie, are important developments to be taken note of. The emergence of a section of the Indian big bourgeosie as more or

less equal partners in joint-ventures with foreign companies has meant the diversion of foreign capital to sectors catering primarily to the domestic market. The expanding market has, no doubt, induced the foreign companies to enter into such joint-ventures with Indian capital.

The implications of the increasing importance of the manufacturing sector will be revealed if we take a detailed break-up of the data relating to this sector. In the following table the period 1948-60 has been divided into two sub-periods, June 1948-end of 1955, and beginning of 1955-end of 1960, in order to highlight the changes in the rate of growth in private foreign investments in the various manufacturing industries as compared to the other important sectors (see Table 12).

In the first sub-period, June 1948-end of 1955, the increase in the petroleum sector was about Rs. 82 crores while that in the manufacturing sector was only Rs. 58 crores. However, during the second period, 1956-60 the increase in foreign investments in petroleum was only Rs. 45 crores or Rs. 9 crores per year as against an increase of over Rs. 55 crores or Rs. 11 crores per year in the manufacturing sector.

The increase in foreign investments in the plantations sector, as we have already noted, was due largely to revaluation of assets. In trading (excluding petroleum trading) there was a net outflow of about Rs. 16 crores during July 1948-55 and a small net inflow of Rs. 3 crores in 1956-60. In three sectors, namely, transport and utilities, financial (non-banking), and managing agencies, there were notable increases in foreign investments during 1948-55; but during the second sub-period 1956-60 these sectors witnessed a reduction in outstanding foreign investments. In the case of mining there was a small increase of Rs. 3.7 crores during 1956-60. Thus it is significant to note that, except for the fictitious increase in foreign investments in plantations through revaluation of assets and the insignificant increase in the mining sector, growth of private foreign investments during 1956-60 took place only in petroleum and the manufacturing sectors.

Table 12

INCREASE IN PRIVATE FOREIGN INVESTMENTS IN INDIA, 1948-59

(Rs. crores)

Sectors	As at the end of June 1948	1955	Increase + Decrease − 1948-55	As at the end of 1960	Increase + Decrease − 1956-60	Increase + Decrease − 1948-60
Petroleum	22.3	104.0	+81.7	149.2	+45.2	+126.9
Mining	11.5	9.6	− 1.9	13.3	+ 3.7	+ 1.8
Manufacturing	70.9	129.1	+58.2	184.3	+55.2	+113.4
Iron & steel products	5.5	8.4	+ 2.9	12.1	+ 3.7	+ 6.6
Transport equipment	—	4.1	+ 4.1	8.5	+ 4.4	+ 8.5
Machinery & machine tools	1.9	5.0	+ 3.1	9.2	+ 4.2	+ 7.3
Cigarettes & tobacco	6.2	24.9	+18.7	24.3	− 0.6	+ 18.7
Electrical goods & electrical machinery	4.8	14.6	+ 9.8	19.2	+ 4.6	+ 14.4
Medicines & pharmaceuticals	0.5	7.7	+ 7.2	17.0	+ 9.3	+ 16.5
Chemicals & allied products (excluding medicines & pharmaceuticals)	2.9	13.2	+10.3	18.1	+ 4.9	+ 15.2
Rubber goods	4.9	6.8	+ 1.9	12.2	+ 5.4	+ 7.3
Textile products (cotton, jute & coir)	24.3	21.8	− 2.5	22.1	+ 0.3	− 2.2
Others	19.9	22.6	+ 2.7	41.6	+19.0	+ 21.7
Trading	43.0	27.1	−15.9	30.2	+ 3.1	− 12.8
Transport & utilities (including construction)	31.2	42.7	+11.5	42.1	− 0.6	+ 10.9
Financial (non-banking)	6.9	27.8	+20.9	22.4	− 5.4	+ 15.5
Plantations	52.3	87.2	+34.9	99.5	+12.3	+ 47.2
Managing agencies	14.4	24.6	+10.2	23.3	− 1.3	+ 8.9
Others	3.3	1.3	− 2.0	2.0	+ 0.7	− 1.3
Total	255.8	453.4	+197.6	[illegible]66.4	+113.0	+310.6

Sources: (i) 1948 Census, app. Statements, 8, 9, 10, and 13; (ii) 1955 Survey, app. Statement, 8; (iii) RBI Bulletin (October 1962) 1540, Statement II.

During the entire period 1948-60, the industries in the manufacturing sector which recorded substantial increases in private foreign investments were the cigarette and tobacco industry, and industries producing electrical machinery, medicines and pharmaceuticals, and chemicals and allied products. Other industries which showed notable increases in foreign investments during this period were transport equipment, machinery and machine tools, iron and steel products and rubber goods.

A break-up of the data into the two sub-periods, however, reveal some interesting facts. In the case of cigarettes and tobacco, although there was a significant increase over the period 1948-60, this increase was true only of the first period 1948-55, there being a reduction in outstanding investments during the second period 1956-60. There was a net outflow of about Rs. 60 lakhs during 1956-60 compared to the substantial increase of about Rs. 19 crores during 1948-55. A similar trend was visible in the case of managing agencies. In industries such as electrical goods and electrical machinery, and chemicals and allied products (excluding medicines and pharmaceuticals) the growth rate was lower in the second sub-period 1956-60 compared to the earlier period 1948-55. The average annual growth rate in electrical goods and electrical machinery during 1948-55 and during 1948-55 and during 1956-60 were Rs. 1.5 crores and Rs. 0.9 crore respectively. Corresponding figures of growth rate in the two sub-periods in chemicals and allied products were Rs. 1.6 crores and Rs. 1 crore.

The textile industry witnessed a reduction in outstanding private foreign investments over the long period 1948-60. Foreign investments in textiles (cotton, jute and coir) decreased by Rs. 2.5 crores during 1948-55; but there was a small increase of about Rs. 30 lakhs during the second sub-period 1956-60.

Manufacturing industries which recorded a higher growth rate during the second sub-period 1956-60 were transport equipment (annual average increase in the two sub-periods being Rs. 0.6 crore and Rs. 0.9 crore respectively), medicines and pharmaceuticals (Rs. 1.1 crores and Rs. 1.9 cro-

res), and rubber goods (Rs. 0.3 crore and Rs. 1.1 crores).

Thus in business lines such as plantations, trading and textiles, which, before independence, were among the most profitable and attractive fields for the investment of foreign private capital, there was either a decline or practically no increase during 1948-60. In certain other sectors such as cigarettes and tobacco (and also in managing agency companies) there were significant increases in foreign capital during 1948-55; but during 1956-60 there was a complete reversal of the position resulting in a net outflow of capital from these sectors. Among the sectors which recorded substantial increases in foreign investments throughout 1948-60, in certain cases there were noticeable decline in the rate of increase in the second sub-period 1956-60, for instance, in petroleum, electrical goods and electrical machinery, and chemicals and allied products. The slowing down of the rate of growth of foreign investments in a strategic sector such as petroleum from Rs. 12.6 crores during 1948-55 to Rs. 9 crores during 1956-60, though significant, may be regarded as the reflection of abnormal outflow during 1958 and the negligible increase in 1959. It is likely that the substantial increase in petroleum investments in 1960 would well be proved as another abnormal flow rather than the beginning of a new rising trend.

A study of the rate of inflow of foreign capital into the major business sectors, petroleum and manufacturing, will show the increasing importance of manufacturing sector as a field which attracts private capital from abroad (see Table 13).

Petroleum accounted for the predominant portion of the total capital inflow from abroad during 1948-57, particularly in 1954 and 1955 and 1957.[36] In 1957 we witnessed the unprecedented phenomenon of petroleum investments constituting practically the entire net inflow of private foreign capital. But the following year, 1958, saw the anti-climax when there was a net outflow of Rs. 15.7 crores of capital from the petroleum sector, gross outflow being Rs. 21.9

36. This was largely a reflection of the significant increase in the activities of foreign oil companies, Burmah-Shell and Stanvac (now ESSO).

Table 13

SHARE OF PETROLEUM AND MANUFACTURING SECTORS IN NET FOREIGN CAPITAL INFLOW INTO INDIA, 1948-60

(Rs. crores)

Years	*Petroleum*	*Manufacturing*	*Others*	*Total private capital inflow*
July 1948-December 1953 (annual average)	10.0	9.7	2.3	22.0
1954 and 1955 (annual average)	13.5	2.5	−1.1	14.9
1956	12.4	3.7	8.8	24.9
1957	17.7	4.3	−4.2	17.8
1858	−15.7	9.6	8.5	2.4
1959	1.1	18.9	−9.0	11.0
1960	29.7	19.0	4.6	53.3

Sources: *RBI Bulletin* (April 1960) 476; (May 1961) 684; and (October 1962) 1534.

crores. The gross inflow in 1959 was also substantial to the tune of about Rs. 13 crores, even though it was offset by capital inflow, thus recording a net inflow of Rs. 1.1 crore. By far the most significant net inflow occurred in 1960 when it touched the peak of nearly Rs. 30 crores. However, the unprecedented increase of 1960 is averaged out by the net inflow of 1958 and the negligible increase during 1959. Thus, the conclusion that increases in foreign petroleum investments, though very significant in some years, do not indicate a steady trend, is justified.

The rate of inflow of foreign capital into the manufacturing sector, on the other hand, has been continually increasing from 1956 onwards. From Rs. 2.5 crores of annual inflow during 1954 and 1955, and Rs. 3.7 crores in 1956, the rate of inflow showed marked improvement to Rs. 9.6 crores in 1958 and over Rs. 19 crores in 1960. Thus, the most conspicuous fact about foreign capital inflow into India in the 1950's has been the steady increase in the capital inflow into manufacturing industries.

The general practice in many countries is to classify

foreign business investments into two broad categories, 'direct' and 'portfolio'. Such a distinction is useful in our analysis because the evolution of the joint-stock company as a dominant form of business organisation has necesarily focussed our attention on an important functional difference between those who own an industry and those who exercise real control over the policy and operation of the enterprise.

Direct investments are sometimes differently called 'equity' investments or 'entrepreneurial' investments. Similarly, the terms 'loans' capital and 'rentier' investments are used by some economists to mean the same as portfolio investments. However, most of the economists seem to use the terms direct investments and portfolio investments.[37] In the publications of the United States Department of Commerce and of the United Nations, this distinction between direct and portfolio types of foreign investments is accepted.[38]

The distinction between direct and portfolio foreign investments is usually based on the assessment as to whether or not ownership and proprietary rights of the foreign investors are accompanied by actual control. If foreign investment is accompanied by control over the enterprise, it is included in the 'direct' category. Branches of foreign companies which are owned and controlled by the parent company abroad are abvious examples of the direct form of foreign investment. These branch organisations are subject to effective control by the head offices located abroad. Such

37. For example, Helmut G. Callis proceeds with his analysis of foreign capital in South East Asia on the basis of this classification. He also uses the terms 'entrepreneur' investments and 'rentier' investments to denote these categories (Callis, *Foreign Capital in South East Asia,* New York, 1952).

38. The United States survey of international private capital for the period of 1946-52 uses this classification and defines the terms as follows: 'Foreign "direct investment" or "entrepreneurial investment" represents investment in enterprises (usually branches or subsidiaries) in the capital importing country. Investments in securities (usually bonds) held predominantly by investors not exercising managerial control are termed "portfolio investment"' (United Nations, *International Flow of Private Capital,* 1946-52, 6).

control extends over the shaping of policy as well as over administrative matters. On the other hand, if foreign investment in the shape of ownership of shares in a company not accompanied by control over the enterprise, it is termed portfolio investment. Obvious examples of such investments are debentures and preference shares, the owners of which do not possess any voting rights or any form of control over the enterprise.

Difficulties in classification arise, however, in the case of certain types of foreign capital. For example, in the case of joint-stock companies registered in India, but in which a sizable portion of the ordinary shares are owned by foreign investors, it is not easy to make a clear distinction. Similarly, the problem arises in the case of Indian joint-stock companies which are controlled by companies incorporated abroad, other than the 'parent' company.

The classification of foreign investments into direct and portfolio categories has been adopted by the Reserve Bank of India in their surveys relating to India's foreign liabilities and assets. In these surveys the Reserve Bank was confronted with the problem of locating foreign control in companies registered in India, but with a certain degree of foreign ownership of shares. In deciding this question the Reserve Bank of India took into account various aspects such as the total number of shares and shareholders of the company, the degree of concentration of shares and their location, the existence of managing agency or other agreements, etc.[39]

According to the classification adopted by the Reserve Bank of India the investments by non-residents in the following types of companies are included in the direct form of foreign investment:

(1) Branches of foreign companies;

(2) Joint-stock companies in which (a) the ownership of 40 per cent or more of its ordinary shares are located in any one country outside India, or (b) if it is a 'subsidiary' to a company registered abroad, or (c) in which 25

39. Reserve Bank of India, n. 15-ii.

per cent or more of its shares are held by another joint-stock company which itself is foreign controlled (but not a managing agent of the former), or (d) if it is managed by a foreign controlled managing agency company.

Portfolio obligations of Indian joint-stock companies, according to the Reserve Bank of India, include deferred shares, preference shares and debentures owned by investors abroad. These shares normally do not carry with them any voting rights or other forms of control over the enterprise. Ordinary shares, on the other hand, confer voting rights on the owners of such shares. But whether ownership of ordinary shares by a non-resident in an Indian joint-stock company amounts to actual control or not depends on the degree of control which the person is in a position to exercise. If the ownership of ordinary shares is of such a nature as not to involve control, then those shares are included by the Reserve Bank of India in 'portfolio' investments. Ordinary shares other than those which come under the purview of the definition of 'direct' investments given earlier, are considered to be 'portfolio' investments. Thus portfolio investments, according to the classification adopted by the Reserve Bank of India include not only 'creditor' (i.e., debentures and preference shares), but also part of the equity capital (ordinary shares and deferred shares) owned by non-residents without actual control over the enterprise.

> In all those obligations where control in regard to a firm or company remained in India, the extent of external investment in the firm or company of whatever category it might be—equity or creditor—is treated as 'portfolio' investment by foreigners.[40]

It should be noted that the above classification is based on the attribute on 'control'. But for an exhaustive study of the role played by foreign investments, it will be useful to make a distinction between the forms of foreign investments on the basis of not only the locus of control, but

40. Reserve Bank of India, n. 15-i, 37.

also on the basis of other criteria, for instance, the nature of service payments.

It is true that a new classification will pose new problems. It is difficult to arrive at a rigorous definition of 'direct' and 'portfolio' investments which will satisfy the requirements of clear-cut functional distinction between them on the basis of the two criteria, namely, the locus of control, and the nature of service payments. This problem of definition is presented in the form of the following set of alternatives:

SCHEME OF ALTERNATIVE DEFINITIONS

On the basis of	*Direct foreign investments to include*	*Foreign portfolio investments to include*
1. The locus of control	1) Investments in branches of foreign firms 2) Part of equity capital (ordinary shares in joint-stock companies with actual foreign control)	1) Creditor capital (a) debentures (b) preference shares 2) Part of equity capital (a) ordinary shares in joint-stock companies without actual foreign control (b) deferred shares
2. The nature of service payments	Securities with variable yield (equity capital only) (a) ordinary shares (b) deferred shares	Securities with fixed yield (creditor capital only) (a) debentures (b) preference shares

We may use two sets of classifications in our study: (i) classification of foreign investments into direct and portfolio investments to study the problems relating to the locus of control, and (ii) classification of foreign investments into equity capital and creditor capital in order to study the questions relating to the nature of service payments.

A study of the trends in the growth of direct and portfolio investments in India will reveal a continuous increase in the share of direct investments and a corresponding fall in the share of private portfolio. The percentage share of direct investments at the end of June 1948 was 82.5 per

cent. It increased to 85.4 per cent at the end of 1955, and 87.7 per cent at the end of 1960. In other words, there has been an intensification of the control exercised by foreign investors on business operations in India.

Portfolio investments consist largely of equity investments which are devoid of actual control. If we isolate the equity shares and calculate the amount of creditor capital, it will be seen that creditor capital constitutes only a very insignificant portion of total private foreign investments in India. The share of creditor capital from private foreign sources was only 2.9 per cent of the total private foreign investments at the end of 1953. The percentage share declined to 2.2 per cent at the end of 1957 and to 2 per cent at the end of 1960. The slow, but continuous increase in the percentage share of equity investments, an increase from 97.1 per cent at the end of 1953 to 98 per cent at the end of 1960, is significant in terms of its implications to balance of payments or the problem of servicing the debt.

The two main forms of business organisation through which private foreign capital has been invested in India are 'branch organisation' and 'controlled Indian joint-stock companies'. Among the controlled Indian joint-stock companies the traditional form has been the organisation of subsidiary companies. The investment of foreign capital in essentially rupee companies has now come to be accepted as a convenient form of foreign capital participation. In recent years, foreign capital has been invested in substantial amounts in joint-ventures through Indo-foreign collaboration.

Branch operations in India by foreign companies involves the complete exclusion of Indian investors from the financing and management of business. The head office of the company abroad directly manages the business activity in India and in legal terms there is no distinction between Indian operations and the operations of the head offices.

The fact that branch business does not involve all the

legal formalities and organisational adjustments which always accompany the separate incorporation of business activities in India has been, no doubt, one of the reasons for the predominance of this form of foreign business organisation. Probably, a more compelling reason has been the possibility of retaining absolute control over the business in India. Again, branch operations in various countries enable the head office to freely transfer resources from one country to another, depending on the needs of business operation and expansion in particular countries from time to time. Thus there is a high degree of flexibility involved in the simultaneous operation of branches in a number of countries.

Branch organisations have been predominant in certain business sectors in India from the early British period. For instance, practically the entire foreign capital in plantations was in branches of companies incorporated abroad. Another traditional industry, namely, jute manufactures has also been organised predominantly in the form of branches. Among the new industries in the foreign sector, petroleum companies provide an example of foreign business through branch organisation.

The growth of subsidiary companies in India was partly in response to the growing national sentiments in India which invariably imbibed the slogan of swadeshi. The business prospects of foreign companies in India rested on their ability to adjust to this national consciousness which seemed to patronise only 'Indian' concerns. The substantial growth of subsidiaries called 'India Limiteds'[41] was the result of the conscious attempt on the part of foreign companies to give an Indian appearance to their business ventures in India. An equally important compulsion for the setting up of subsidiary companies in India by many foreign companies has been the desire to reap the advantages of protection offered to 'Indian' companies.

A study of the relative growth of private foreign invest-

41. The long list of 'India Limiteds' include Parke Davis (India) Ltd., Merck Sharpe & Dhome (India) Ltd., Kores (India) Ltd., Dunlop Rubber Co. (India) Ltd., and Candy Filters (India) Ltd.

ments in branches and controlled Indian joint-stock companies reveals the tendency towards a decline in the importance of investments in branches and a corresponding increase in the relative share of controlled Indian joint-stock companies. Foreign investments in branches of foreign companies accounted for about 53 per cent of total private foreign investments in India at the end of June 1948. It showed an increase in the following years, reaching 56 per cent at the end of 1956. This increase was largely due to significant increases in the petroleum sector. But from 1957 onwards, the percentage share of branch companies witnessed a continuous decline, recording about 52 per cent at the end of 1958 and 48.7 per cent at the end of 1960. On the other hand, the percentage share of controlled Indian joint-stock companies increased from 29.4 per cent at the end of June 1948 to 39.9 per cent at the end of 1960.

Table 14

PERCENTAGE SHARE OF DIFFERENT FORMS OF FOREIGN CAPITAL, 1948-60

As at the end of	*Direct investments*			*Portfolio*
	Branches of foreign companies (net assets)	*Controlled Indian joint-stock companies*	*Total*	
June 1948	53.1	29.4	82.5	17.5
1953	55.4	27.9	83.3	16.7
1955	56.1	29.3	85.4	14.6
1956	56.1	31.1	87.2	12.8
1957	55.4	32.2	87.6	12.4
1958	51.9	35.5	87.4	12.6
1959	48.3	39.3	87.6	12.4
1960	48.7	39.9	88.6	11.4

The above table does not give the relative share of subsidiary companies separately from that of controlled Indian joint-stock companies in general. Detailed information available from the Reserve Bank studies on the investment in subsidiary companies does not enable us to have a com-

plete time series analysis. At the end of June 1948, about 60 per cent of the total foreign investments in controlled Indian joint-stock companies were in subsidiaries. This percentage share seems to have increased substantially by the end of 1959. An estimate on the basis of available data shows that about 90 per cent of the increase in foreign investments in the controlled Indian joint-stock companies during 1948-59 was accounted for by subsidiary companies.

The decline in the relative share of branch investments, however, do not indicate any real decrease in the degree of control exercised by the foreign investors. The control exercised by the parent companies abroad over their subsidiary companies in India, in real terms, is not much different from the control applied by foreign companies over their branch organisations in India. Moreover, branch organisations still constitute the major portion of direct foreign investments in absolute terms. The total number of branches of foreign companies which were registered in India was 565 at the end of March 1960. About 40 per cent of these branches, of course, consisted of branches of foreign banks and insurance companies, airlines, shipping companies, and even branches of companies which had gone into liquidation or had ceased to function.[42]

An industrywise classification of the data reveals the interesting fact that in the manufacturing sector, the most dynamic sector in recent years, the predominant form of foreign business organisation is the subsidiary company while in sectors such as plantations, trading, mining, and transport and utilities, which were traditionally the most important sectors attracting foreign capital, the branch organisation continues to be major form (see Table 15).

Branches account for about 95 per cent of the total private foreign investments in plantations, 81 per cent in transport and utilities, 83 per cent in mining, and 51 per cent in trading. In petroleum also a substantial percentage of total foreign investments, to the tune of about 60 per cent,

42. 'Finances of Branches of Foreign Companies and Foreign Controlled Rupee Companies, 1957 to 1959', *RBI Bulletin* (March 1962) 344.

Table 15

FORMS OF BUSINESS ORGANISATION IN THE PRIVATE FOREIGN SECTOR IN INDIA AT THE END OF 1960

(Industrywise classification)

(Rs. crores)

Sectors	*Direct investments*			*Portfolio*	
	Net assets of branches of foreign companies	*Controlled Indian joint-stock companies*	*Total*	*Investments*	*Grand total*
Petroleum	88.8	60.2	149.0	0.2	149.2
Manufacturing	27.2	121.4	148.6	35.7	184.3
Mining	11.0	0.8	11.8	1.5	13.3
Trading	15.3	11.6	26.9	3.3	30.2
Transport & utilities (including construction)	34.2	3.7	37.9	4.2	42.1
Plantations	94.4	0.5	94.9	4.6	99.5
Financial	0.8	12.1	12.8	9.6	22.4
Miscellaneous	4.2	15.6	19.7	5.6	25.3
Total	275.8	225.9	501.7	64.7	566.4

Source: *RBI Bulletin* (October 1962) 540.

is in branches. In contrast, the percentage share of branches is very low in the manufacturing sector with just about 15 per cent.

The predominant form of foreign business organisation in the manufacturing sector is the shareholding by foreign companies in Indian joint-stock companies controlled by them, mainly their Indian subsidiaries. In this sector the percentage share of parent companies in the paid-up capital in subsidiaries was as high as 88 per cent in 1959. Within the manufacturing sector the individual industries in which the shareholdings are the most significant are iron and steel hardware, non-ferrous metals, chemicals, soap, and cigarettes and tobacco.

A new trend in the foreign capital inflow into India after independence has been the participation of foreign capital

shares of foreign participants in total new capital issues in the various manufacturing industries were less than 50 per cent.

Table 17

NEW ISSUES OF CAPITAL IN THE MANUFACTURING SECTOR, JANUARY 1951-JUNE 1957

(Rs. lakhs)

Industries	*Amount consented by the Controller of Capital Issues*	*Amount to be subscribed by foreign participant*	*Percentage of (3) to (2)*
(1)	(2)	(3)	(4)
Printing & paper	109.00	24.45	22.4
Glass	135.00	69.10	51.2
Sewing thread	323.00	309.00	95.7
Cement	275.00	90.00	32.7
Chemicals	783.00	376.41	49.1
Pharmaceuticals	5.00	3.00	60.0
Rubber goods	250.00	62.50	25.0
Electrical goods	284.00	89.40	31.3
Machine tools	325.00	40.43	12.4
Diesel engines	83.50	20.62	25.0
Steel tubes	460.00	198.40	43.1
Non-ferrous metals & alloys	45.00	15.00	33.3
Automobiles & trucks	510.00	82.50	16.2
Cycles & accessories	30.00	12.00	40.0
Others	726.37	167.28	23.0
Total	4343.87	1559.73	35.9

Among individual companies, special mention may be made of the participation of J & P Coats Ltd. (UK) with the Jumna Thread Mills (Private) Ltd., Bombay, for the manufacture of sewing thread in India (the foreign participant to subscribe the entire new issue of Rs. 2.95 crores), the subscription of Rs. 62.5 lakhs by International B.F. Goodrich (USA) in the new capital issue of Rs. 2.50 crores of the Travancore Tyres & Rubber Co. Ltd., the participation of the Imperial Chemicals Industries (UK) to the extent of Rs. 1.6 crores out of Rs. 2 crores in the Indian

Explosives Ltd., and the investment of Rs. 80 lakhs by Diandeer Benz A. G. (Germany) out of the new issues of Rs. 5 crores by the Tata Locomotive & Engineering Co. (Private) Ltd., for the manufacture of heavy diesel trucks and chassie.

The second half of the 1950's witnessed an unprecedented increase in the number of Indo-foreign collaboration agreements. Since 1957, this has been the predominant pattern of private foreign capital investment in India. Even though this was, by and large, limited to the manufacturing sector, in terms of the large variety of manufacturing industries which came under its coverage, its impact has been decisive.

The 'convertibility' agreement between India and the United States entered into in 1957, no doubt, gave a stimulus to a large number of American concerns to enter into collaboration with Indian firms. It was reported that, immediately following the convertibility agreement, several American companies applied to the US International Co-operation Mission for investing about 7 million dollars in India.

Data relating to capital issues show that the total capital issued to foreign residents and approved in manufacturing industries during the period 1957-June 1961 amounted to about Rs. 74 crores. Out of this, Rs. 45 crores were for new enterprises and the rest for existing enterprises. The increasing tempo of foreign collaboration in Indian industries during 1957-61 is clearly evident from the following table:

Table 18

CAPITAL ISSUES TO FOREIGN RESIDENTS IN THE MANUFACTURING SECTOR, 1957-61

	Rs. crores
1957	9.0
1958	9.6
1959	18.8
1960	19.4
1961 (January-June)	17.4
Total	74.3

The relative positions of foreign capital in the important manufacturing industries during 1957-61 are given below:

Table 19

NEW CAPITAL ISSUES IN THE MANUFACTURING SECTOR INVOLVING PRIVATE FOREIGN INVESTMENT, 1957-61

(Rs. crores)

Industries	*Amount consented by the Controller of Capital Issues*	*Amount to be subscribed by foreign participants*	*Percentage of (3) to (2)*
(1)	(2)	(3)	(4)
Machinery and transport equipment	82.3	30.4	37.0
Basic metals and metal products	46.3	8.6	18.6
Chemicals and allied products	62.5	21.2	34.0
Other manufacturing industries	66.8	14.1	21.1
Total	257.9	74.3	28.2

As can be noted from the preceding table, the percentage shares of foreign investments in total new capital issues in the various manufacturing industries were below 50 per cent. It is true that in the majority of cases foreign capital participation has been on the basis of minority share, effective control over the industry being retained by Indian investors. However, in a number of cases, foreign participation has taken place to the extent of changing the effective control position of the industries concerned, a fact which is concealed in the above table due to aggragation. Thus, contrary to the original policy declarations of the Government of India, foreign investors have been allowed to have a majority share in the capital of Indian enterprises.

It is important to note that in the manufacturing sector practically the entire amount of capital issues to foreign residents during 1957-61 was accompanied by the issue of new rupee capital. Out of the total capital issues to foreign residents amounting to over Rs. 74 crores, about

Rs. 72 crores were accompanied by the issue of rupee capital.

Majority foreign participation in capital has been, by and large, a phenomenon characteristic of the relationship between foreign companies and their Indian subsidiaries. Some of the important companies involving such majority participation during 1957-61 were Merck Sharpe & Dohme (India) Private Ltd., Park Davis (India) Ltd., Roche Products Private Ltd., and Smith & Nephew (India) Private Ltd., all engaged in the manufacture of pharmaceuticals and chemical products, CEAT Tyres of India Ltd. (manufacture of tyres and tubes), Atlas Copco (India) Private Ltd., (portable compressors and drills) and Mather Greaves Private Ltd. (calender bowls for textile industry).

The number of cases of majority participation by foreign companies was the largest in pharmaceuticals and chemicals. Nearly half the number of majority capital issues during 1957-61 was in this sector. The share of foreign participants in the total capital issues was also quite high in the case of pharmaceuticals and chemicals. For example, in the total new capital issues approved in Parke Davis (India) Private Ltd., the parent company, namely, Park Davis & Co., USA, has 83.3 per cent shares. Again, F. Hoffman Roche & Co. of Switzerland has contributed 89 per cent of the capital in its Indian subsidiary Roche Products Private Ltd. The tie-up of Merck & Co., USA with the Tata Sons for the establishment of the subsidiary Merck Sharpe & Dohme (India) Private Ltd., involves an authorised capital of Rs. 4.2 crores out of which 60 per cent has been issued to the foreign company.

The percentage share of foreign investors has been quite high in the case of several other industries also. For instance, Horlicks Ltd., UK, has invested 83.3 per cent of the capital in Hindustan Milk Food Manufactures Private Ltd. Similarly, Nestles Holdings Ltd., Bahama Island, have a capital participation of 90 per cent in Food Specialities Private Ltd. In rubber manufactures special mention may be made of the tie-up between the Tatas and CEAT, Italy, in the establishment of CEAT Tyres of India Ltd. for the manufacture

of tyres and tubes. The parent company in Italy hold 60 per cent of the share capital in CEAT Tyres of India Ltd., the rest being held by the Tatas.

The declared policy of the Government of India with regard to Indo-foreign collaboration has been to insist upon majority Indian participation, except in special circumstances. But from the beginning of the Second Five Year Plan, the government, in their enthusiasm to attract larger private foreign capital, have been strangely lenient in the implementation of this policy, thus resulting in the virtual repudiation of declared policy.

The departure from declared policy has been, no doubt, prominent in the case of foreign investments in the private sector industries in India. Even in the case of a few public sector industries the Government of India have allowed majority participation to private foreign investors. For instance, the government entered into an agreement with the British combine, the Imperial Chemical Industries Ltd. (ICI) for the establishment of the Indian Explosive Factory at Gomia (Bihar) to manufacture an item of great importance for our irrigation, power and mining development, namely, commercial high explosives.[45] The Imperial Chemical Industries were allowed to contribute 80 per cent of the issued and subscribed capital of this company. According to the agreement, the foreign company has also the controlling voice in the Board of Directors with 5 members as against only one representative of the Government of India. Royalty is to paid at the rate of 2.5 per cent of the gross annual turnover for the services rendered in the construction of the company and in giving necessary information and assistance in the initial functioning of the factory. Such royalty payments are to start from the beginning of actual production and continue till a total amount equal to 10 per cent of the total capital cost of factory and housing construction has been paid to the ICI. Royalty at the rate of 2.5 per cent of the gross annual turnover is also to be paid for information and assistance given by the ICI

45. *Lok Sabha Debates*, 8 December 1958.

after the factory has started production. In addition, the ICI is to act as the selling agents of the Indian company.

In addition to the large number of Indo-foreign collaborations in the form of capital participation, a very substantial number of technical collaboration agreements have been signed in recent years. Even though many agreements between Indian and foreign firms involve participation in both capital and technical know-how, there is an increasing number of purely technical collaboration agreements.

Essentially there is very little difference between the two forms of collaboration. In many cases, issue of equity capital to the foreign participants is a form of payment for the technical know-how supplied by them. Capital participation involves the consent of the Controller of Capital Issues, and as such, information about this type of collaboration is more or less readily available. On the other hand, information relating to collaboration agreements involving the use of foreign technology and know-how is scattered in the numerous announcements of the companies concerned. The impact of these agreements are reflected on the balance of payments of the country in the form of payments for royalties and fees to the foreign participants.

During the period 1957-61 the total number of technical collaboration agreements entered into between Indian enterprises and companies abroad amounted to about 1,100. There was a remarkable increase in the number of such agreements from year to year. The number of technical collaboration agreements in 1957 was only 24; it was 109 in 1958, 162 in 1959, 388 in 1960 and about 420 in 1961. The big boom in foreign technical collaborations in 1960 and 1961 with a record of over 800 such agreements, we have come to a stage in India where, for practically every Indian industrialist in the manufacturing sector, collaboration with some foreign company is an essential lever for the success of a new venture.

The largest number of technical collaboration agreements have been with American enterprises. The share of the United Kingdom has not been very significant. The manufacturing sectors where foreign technical collabora-

tion agreements are significant include machinery, electrical goods, transport equipments, engineering industries, chemicals, and fertilizers. Over 70 per cent of these agreements in 1960 and 1961 were in metallurgical and engineering industries. About 10 per cent of the agreements, however, were in sectors of very low priority in terms of the needs of planned development, namely, in non-essential consumer industries producing refrigerators, air conditioners, motion-picture projectors, cameras, gramaphone records, shoes, dolls, etc.

The terms and conditions of the collaboration agreements need careful scrutiny. Some of the provisions made in collaboration agreements have serious implications to the national economy. It is an open secret that many agreements prohibit the Indian companies from the sale of commodities produced under joint-ventures in specified foreign markets. It is unfortunate that the actual implications of these agreements cannot be detected in any precise manner with the scanty information that is available on the subject. Apart from the limited data made available by the companies concerned either through their prospectuses or through public announcements, virtually no information is available which a researcher can make use of.[46] A veil of secrecy has been placed on such vital matters for the national economy as the dissemination of technical know-how, training of Indian nationals, and various types of fees and royalty payments to foreign companies.

The substantial growth of Indo-foreign collaboration has to be explained largely by the various mutual benefits which they offer to both Indian and foreign participants in the joint-ventures. For the Indian big bourgeoisie, this gives an opportunity to strengthen their position relative to other sectors of the Indian bourgeoisie. By associating with established and well-known foreign companies, and by using the standard names of their products, the Indian big industrialists have succeeded in offering effective competition to other

46. Some details of collaboration agreements, as available from prospectuses and company announcements, are given in Appendix II.

Indian concerns already in the field and also in trying to thwart the attempts of relatively less resourceful Indian industrialists to rise in competition to them. The name of a foreign company appearing as collaborator in the prospectus or public announcements of an Indian company not only facilitates the prompt mobilisation of domestic capital, but also the sales promotion activities of the firm once production gets going.

Capital and technical collaboration with foreign companies, however, is not resorted to exclusively by Indian big bourgeoisie. In the manufacturing sector it is widely prevalent in all sections of the Indian bourgeoisie. Even small and weak Indian business concerns have entered into collaboration agreements with foreign companies. In such cases, usually the foreign participant is a relatively small and weak company abroad. Instances of Indian firms making use of the names of virtually bogus companies abroad are also not very rare.

For the foreign business companies, technical collaboration is often a means of gaining effective control over the Indian concerns to a degree quite disproportionate to the equity share capital. The enthusiasm of many foreign companies in entering into technical collaboration agreements is a reflection of their anxiety to avoid the possible risks of new industrial ventures. Thus technical collaboration is a preliminary step for ascertaining the feasibility and profitability of more intimate collaboration in the form of equity participation in the future. Again, in the case of certain joint-ventures, the main objective is to jump over our import walls. In the case of many commodities which are subject to import restrictions, there is a significant divergence between foreign prices and domestic prices. Thus it is advantageous for the Indian and foreign participants in the joint-venture to manufacture these commodities in India and share the abnormal profits.

Indo-foreign collaborations have, thus introduced a new dimension to the alignment between Indian bourgeoisie and foreign monopoly capital and widened the field of foreign capital penetration.

Chapter IV

External Assistance from Governments and International Agencies

The most conspicuous fact about India's foreign economic relations during the last decade has been the massive foreign economic aid mobilised by the government from foreign public sources. The absolute volume of foreign aid as well as its relative share in domestic investments have posed a number of problems of immense significance for India's economic progress.

External economic assistance or aid is distinguished from international private capital movements of a commercial nature. International private capital moves from one country to another on the basis of commercial or business considerations of profit and private expectations. On the other hand, the motive of international capital aid is assumed to be the desire to assist the recipient countries in their economic development. Alternatively, international economic aid may be defined as 'that part of the capital inflow which normal market incentives do not provide'.[1] Public foreign capital consists mainly of two categories, namely, capital resources received from international organisations and agencies, and capital received from foreign governments. They include various types of capital assistance: grants, loans repayable in the local currency or in the foreign currency, 'soft' loans, capital aid out of local currency proceeds of surplus commodity sales and short-term credits

1. P. N. Rosenstein-Rodan, 'Economic Assistance to Requirements of Underdeveloped Countries' in *Economic Weekly*, Annual Number, 4 February 1961, 224.

for the import of foreign commodities. The wider term, 'foreign economic aid' also covers various forms of foreign technical assistance.

According to the estimates of the First Five Year Plan, foreign public capital was originally expected to account for Rs. 158 crores or about 7.8 per cent of the total Plan outlay. But during the Plan period the Government of India secured authorisations from foreign governments and international agencies for a total capital of Rs. 297.6 crores. However, the actual utilisation of external resources was only about 63 per cent of the total authorisation. This worked out to about 10 per cent of the total Plan outlay, about 2 per cent more than what was originally expected.

The United States has been the major creditor in the field of foreign public capital. Its aid programmes in India started in December 1950 with the signing of the Point-Four Technical Assistance Agreement between the Indian and United States governments. The US wheat grant, later converted into the Wheat Loan, contracted in 1951, was for a total amount of Rs. 90.31 crores. Another agreement with the US government, the General Agreement of January 1952, laid down the character of the aid; it was then stipulated that the aid would be for importing goods and equipment for agricutural development, and the rupee expenditure in connection with the aid programme in India was to be met by the Government of India.

The character of the aid underwent certain changes in 1953-4 when aid was provided for in other fields of economic development. In August 1953 the US Congress approved an outright grant to India of Rs. 42.4 crores for the year 1952-3. By agreement Rs. 10 crores from this grant was authorised for purchasing wagons and locomotives for Indian railways. Along with this type of develoment assistance provision was also made for technical assistance. For the year 1953-4 the US authorised a sum of Rs. 36.7 crores by way of economic and technical aid: Rs. 28.8 crores for economic aid and Rs. 7.9 crores for technical aid. In 1954 another agreement was signed between the two governments by which the US, under the Indo-US Technical Cooperation

Agreement, undertook to provide Rs. 5.2 crores for the Rihand River Valley Project. During 1954-6, India received about Rs. 45.2 crores, mainly under Development Assistance.[2]

It is significant to note that the 'agricultural fundamentalism' of India's First Five Year Plan happily coincided with the preference of American foreign aid policy for agricultural development in the recipient countries. The underlying philosophy of US aid, particularly up to 1957, insisted on an essentially non-industrial path of development for the predominantly agricultural and primary producing underdeveloped countries. And industrial development has all along been conceived of in relation to the slow and natural growth via private enterprise as distinct from deliberate industrialisation under the auspices of the state.

Up to the year 1955-6 India received inter-governmental assistance from the US for agriculture and community development amounting to about Rs. 32 crores which was earmarked for various projects in the following order.

Table 20

Projects	*Rs. crores*
1. Community Development, etc.	6.57
2. Fertilisers	12.05
3. Ground-water irrigation	11.23
4. Agricultural education and research	1.95
5. Other agricultural schemes	0.48
Total	32.28

In the field of Community Development, the major attention given by US assistance was in the training of village-level workers and other supervisory personnel. During the First Plan period, 43 training centres were established and training was given to about 10,000 village-level workers and 6,000 supervisory personnel. American assistance received for irrigation and power projects was utilised mainly for heavy equipment for the construction of the Rihand Dam project in the UP, the Hirakud Dam, Kakrapara, Mahi, Ghataprabha and Chambal projects.

2. Government of India, Ministry of Finance, *External Assistance During the First Five Year Plan*, 4-5.

A technical cooperation agreement was entered into between the Governments of India and the United States on the 15 September 1951.[8] Under the technical aid programmes the US government agreed to meet all the emoluments of American experts, their subsistance allowance and travelling expense to and fro. The Government of India, on their part, agreed to meet the local expenses, such as expenses for travelling and transportation within India, office space and secretarial assistance. By 1954 there were 89 Americans working in India under various technical assistance programmes.

In the non-agricultural sector US aid has been made available to a large extent for economic overheads. During the First Plan period India received about Rs. 15.4 crores from the US for railway rehabilitation. Provision was made for the supply of 100 locomotives and 8,000 wagons. In the foreign aid policies of the US the emphasis on economic overheads stems from the basic premise, namely, the promotion of private enterprise. Transportation, communications and other overhead facilities are a basic prerequisite for the growth of private enterprise in the underdeveloped countries.

Another important source of external assistance during the First Plan period was the Colombo Plan countries. The assistance from the United Kingdom, the major partner in the Colombo Plan, was negligible and was almost entirely in the form of technical assistance. By 1954, 11 British technicians were working in the Chittaranjan Locomotive Factory under Colombo Plan technical cooperation scheme. The British government paid the salaries and allowances of these technicians and the passage to India and back. Expenses incurred within India were met by the Government of India. Canadian assistance under the Colombo Plan amounted to over Rs. 32 crores out of which about Rs. 19.7 crores were utilised during the Plan period. According to an agreement between the Government of India and the Canadian government, the additional counterpart funds

8. *Parliamentary Debates* (4 October 1951), Pt. I, vol. 10, No. 8, 1962.

raised out of Canada's economic assistance to India under the Colombo Plan were released to the benefit to India. The counterpart funds provided by India amounted to about Rs. 8 crores. Among the projects which benefited by Canadian assistance were the Umtru Hydro-electric Project in Assam and the Mayurakshi Project (out of counterpart funds). A substantial portion of Canadian assistance, however, went into railway development. Under Canadian assistance programmes to India, about 120 locomotives were supplied and also about 840 vehicles for the Bombay State Road Transport Corporation.

Assistance from the Australian government under the Colombo Plan amounted to a total authorisation of about Rs. 11 crores out of which half was utilised during the First Plan period. In addition to providing construction equipment for the Tungabhadra project and the Ramagundam power project, Australia supplied 1,000 meter-gauge wagons and 24 diesel railcars for Indian railways. In 1955-6 Australia agreed to provide a further number of 1,000 wagons for the railways. Under the Colombo Plan, New Zealand also extended economic assistance to India to the extent of Rs. 1.7 crores. However, only a small sum of Rs. 35 lakhs could be utilised during the First Plan period.

The major portion of the foreign assistance received from Norway was in the field of fishery development. A Fisheries-cum-Community Development Scheme was undertaken in 1953-4 with Norwegian assistance. The main aim of the project is the development of fisheries in Kerala through the provision of mechanised boats and better methods of catching, preservation and marketing of fish.

The following table gives a complete picture of the international public capital received from foreign governments and utilised by India in the public sector of the First Plan (see Table 21).

The International Bank for Reconstruction and Development (IBRD) has been an important source of external public capital for India's five year plans. The foreign exchange resources mobilised through the World Bank have been utilised both in the private and public sectors and

Table 21

EXTERNAL ASSISTANCE FROM FOREIGN GOVERNMENTS, AUTHORISED AND UTILISED, 1951-6

(Rs. crores)

	Total authorisation during the First Plan	*Amount utilised during the First Plan*	*Amount undisbursed as at the end of the First Plan*
1) *United States:*			
Total	*235.0*	*163.0*	*72.0*
(a) Wheat Loan	90.3	90.3	—
(b) Loans under T.C.A. (excluding P.L. 665)	27.4	2.3	25.1
(c) T.C.A. grants (excluding P.L. 665)	85.6	42.0	43.6
(d) P.L. 480 Titles II and III	26.1	26.1	—
(e) Ford Foundation	5.6	2.3	3.3
2) *Colombo Plan*			
Total	*45.5*	*25.3*	*20.2*
(a) United Kingdom	0.4	0.1	0.3
(b) Canada	32.3	19.7	12.6
(c) Australia	11.1	5.2	5.9
(d) New Zealand	1.7	0.3	1.4
3) *Norway*	*0.3*	*0.2*	*0.1*

in diverse ways, in industry and agriculture, and in certain cases, for meeting the foreign exchange needs of repayment and interest charges.

The total loans received from the IBRD between 1949, that is the year in which the IBRD loans began to flow into India, and the beginning of the First Five Year Plan amounted to Rs. 27 crores including Rs. 15.61 crores for railways, Rs. 7.96 crores for the D.V.C. and Rs. 3.43 crores for agriculture.[4] The entire amount received from the IBRD before the commencement of the First Plan was utilised during the First Plan period itself. India received another sum

4. *RBI Bulletin* (March 1959) 309.

of Rs. 30.3 crores during the First Plan period, both for the public and private sectors, out of which only Rs. 6.9 crores were actually utilised for the First Plan. The rest, that is, Rs. 23.4 crores were made available for utilisation in the Second Plan.

Table 22

LOANS RECEIVED FROM THE IBRD DURING 1949-56

(Rs. crores)

	Amount authorised up to the end of the First Plan	*Amount utilised up to the end of the First Plan*	*Balance*
A. *Loans to the Private Sector*: Total	*25.3*	*4.9*	*20.4*
(a) Trombay—I	6.6	2.1	4.5
(b) I.I.S. Co—I	13.9	2.8	11.1
(c) I.C.I.C.I.	4.8	—	4.8
B. *Loans to the public sector*: Total	*32.0*	*29.0*	*3.0*
(a) Railways—I	15.6	15.6	—
(b) Agriculture	3.4	3.4	—
(c) D.V.C.—I	8.0	8.0	—
(d) D.V.C.—II	5.0	2.0	3.0
Total	57.3	33.9	23.4

The direction of World Bank loans, as can be seen from the above table, is as much a reflection of the scale of priorities of the First Plan as the project preferences of the World Bank. The emphasis on agriculture and irrigation projects and economic overheads is characteristic also of public foreign capital from the United States and the capitalist countries in general. In the foreign aid policies of these countries and the World Bank the emphasis on economic overheads stems from the basic premise, namely, the promotion of private enterprise in the recipient countries. Transportation, communications and other overhead facilities are a basic prerequisite for the growth of private enterprise, particularly in the underdeveloped countries.

At the commencement of the Second Plan there was

over Rs. 110 crores of public foreign capital at the command of the Government of India, this being the balance left unutilised during the First Plan period. The Second Plan was originally based on the estimate that foreign capital to the extent of about Rs. 800 crores would be required from foreign public sources. Even though there was no certainty about the availability of the entire amount contemplated, the Second Plan had an encouraging start with offers of external assistance from a number of foreign governments. A redeeming factor was the emergence of new countries in our list of creditor nations, particularly the Soviet Union. This brought about not only quantitative, but also qualitative changes in the economic assistance channelled through bilateral methods. With the increasing preference of US foreign aid to go into sectors related to agriculture and surplus commodities import on the one side, and the increasing compulsion of the Indian economy to give priorities to basic and heavy industries in the plan on the other, India was facing a dilemma. The possibility of getting external aid from the Soviet Union and West Germany and the United Kingdom for the setting up of steel plants and machine producing plants in India brightened up the prospects of the Second Plan.

The foreign exchange crisis of the first two years of the Second Plan, however, altered all the earlier calculations of the Government of India and the Planning Commission about the magnitude of external resources needed for fulfilling the production targets of the Plan and filling the gap in foreign payments. The crisis in India's international payments not only led to the pruning of the Plan, keeping only the so-called 'core', but also to an increased reliance on foreign aid. Consequently, we received about Rs. 960 crores of financial assistance from foreign public sources during the first two years of the Second Plan, as against Rs. 800 crores originally estimated as the requirement for the entire five years of the Second Plan.

The major institutional framework through which these additional resources were mobilised was what is generally known as the Aid India Club or the Consortium. On

25 August 1958 and the following days India's major international creditor-countries met privately at the World Bank, Washington, to discuss India's payments problems and to find out means to render financial aid to India. India sought about 1,000 million dollars of foreign currency aid for the period up to March 1961, that is, up to the end of the Second Plan. India, however, needed for immediate requirements about 350 million dollars by 1 March 1959. The rest was to be spread over the remaining period of the Second Plan. After the deliberations of the Aid India Club, the US government announced a loan from the Development Loan Fund amounting to 100 million dollars, and the World Bank announced a loan for Indian railways amounting to the same figure. The loans promised by the United Kingdom, West Germany, Canada and Japan were 108 million dollars, 40 million dollars, 17 million dollars and 10 million dollars respectively.[5] For the period March 1959 to the end of the Second Plan, the World Bank announced their willingness to negotiate new credits totalling 225 million dollars. West Germany and Canada also promised assistance for the last two years of the Second Plan amounting to Rs. 29.2 crores and Rs. 11.2 crores respectively.

The manner in which the Aid India Consortium functions sets a precedent which has significant implications. Under the auspices of the World Bank India's chief creditor-countries meet to discuss India's requirements of foreign assistance. The aid commitments by the members of the Consortium are announced only after serious discussions about the economic policies and programmes of the Government of India. In theory these discussions are meant to enable the member-countries to comprehend and appreciate the needs of the Indian economy and to ensure the optimum utilisation of the resources made available by the Consortium. But in practice they provide an occassion for putting pressure on the Government of India to change or modify some of the policies which are contrary to the

5. *Hindustan Times* (New Delhi), 30 August 1958.

private enterprise philosophy of the Consortium members.

United States remained the major partner in the Aid India Consortium with over Rs. 1,480 crores of total aid authorisations during the Second Plan period. The large volume of aid commitments from the US was made possible by a proliferation of statutary organisations and agencies catering to a large variety of aid preferences of the recipient country, India. The enlargement of the credit functions of the Export-Import Bank, the innovation of the Development Loan Fund, the President's Asian Economic Development Fund and local currency assistance schemes under P.L. 480 and P.L. 665, and recently the coordination of the functions of the various agencies under US AID (Agency for International Development), not only helped in expanding US aid to India but also to change the structural composition of aid.

The Indo-US Technical Cooperation Programme which commenced its activities in 1952 was continued during the Second Plan period. The development assistance loans contracted under this programme were received partly in dollars and partly in the form of rupee proceeds from the sale of imported surplus commodities under P.L. 665. The rupee proceeds from the sale of wheat and cotton imported under the Technical Cooperation Programme were deposited by the Government of India in favour of the US government. The rupee funds in the US government account as at the end of June 1961, stood at about Rs. 32 crores, out of which about Rs. 19 crores were advanced for the Rihand Valley Development Project.

In the foreign aid programmes of the US an important development was the establishment of the Development Loan Fund (DLF). Under the provisions of the Mutual Security Act of 1957 the DLF was incorporated in 1958 as an independent government corporation. The total DLF loans extended to India up to the end of 1961 amounted to about Rs. 326 crores out of which about Rs. 102 crores were earmarked for power projects and about Rs. 55 crores for railway development. Other sectors for which DLF loans have been made available are the manufacture of road

transport vehicles, fertilisers, the procurement of steel and other commodities. The Industrial Finance Corporation also received a loan from the DLF to be lent to the private sector.

The predominant portion of the DLF loans were given directly to the Government of India. In the case of government corporation or companies the provisions of the DLF require the government to sign as guarantor. Thus the Fertilisers Corporation of India, the Industrial Finance Corporation and the National Small Industries Corporation received loans directly from the DLF, the Government of India signing as guarantor.

Under the Mutual Security Act of 1957 DLF is permitted to extend loans directly to the private sector companies abroad without any guarantee from the governments of the recipient countries. Up to the end of 1961 the DLF extended loans amounting to a total of about Rs. 7.7 crores to three private sector companies in India, namely, Ahmedabad Electricity Co., Ltd., Premier Automobiles, and Industrial Credit and Investment Corporation of India Ltd.

An important source of public foreign capital from the US during the Second Plan has been the Export-Import Bank of Washington, an agency of the US government. The purpose of the Bank is to encourage the foreign trade of American private enterprise. Under the provisions of the Export-Import Bank Act of 1945 the Bank makes dollar loans and also gives guarantees to assist US overseas trade.

The Export-Import Bank extended a credit in June 1958 to the Government of India amounting to Rs. 71.4 crores for the purchase of capital goods from the US. This was for purchases by the private sector industries as well as for some government projects. In January 1961 another agreement was signed by which the Export-Import Bank agreed to give a credit of Rs. 23.8 crores.

The dollar loans given by the Export-Import Bank directly to the private sector industries up to the end of 1961 amounted to about Rs. 16.2 crores. This included an exporter's credit of about Rs. 86 lakhs to the National Rayon Corporation of India and loans amounting to Rs. 6.2 crores and Rs. 8.8 crores to Hindustan Aluminium Ltd. and Orient

Paper Mills respectively.[6]

In addition to the dollar loans made under the provisions of the Export-Import Bank Act of 1945, the Bank was empowered by the 'Cooley Amendment' of 1957 to Section 104 (e) of the Agricultural Trade Development and Assistance Act of 1954 (Public Law No. 480) to extend loans in the local currencies of the recipient countries.[7] Rupee loans approved by the Export-Import Bank under the above scheme amounted to Rs. 12.78 crores by the end of 1961. This included Rs. 2.25 crores to the Goodyear Tyre and Rubber Company of India (Private) Ltd., Rs. 3.92 crores to Synthetics and Chemicals Ltd., Rs. 1 crore to Hindustan Aluminium Corporation Ltd., and Rs. 2 crores to Seshasayee Bros.

A substantial portion of US aid to India has been in the form of surplus commodity assistance. In a sense the receipt of commodities from abroad under any arrangement of easy payment is a form of aid. But the special significance of US surplus commodity aid lie in the fact that a large part of the rupee resources created by the sale of these commodities within the country are given to the Government of India in the form of loans and grants.

In general there are two types of 'local currency' accounts which are subject to some control by the US foreign aid agencies. Firstly, there are local currency 'counterpart accounts' owned by the recipient countries. Even though the rupee resources are owned by the government of the recipient country, the use of counterpart funds have to be approved by the US government. In this category may be included the commodity assistance under Mutual Security Programme grants and also in certain cases grants under P.L. 480, Title II. Secondly, there are local currency accounts arising out of the sale of surplus commodities and owned by the US, out of which loans and grants are extended to

6. Government of India, Ministry of Finance, *External Assistance, 1961*, 15.

7. From the 31 December 1961, the responsibility for loans to private sector under Section 104(e) of the Act was transferred from the Export-Import Bank to US AID (Agency for International Development).

the recipient country concerned. These funds arise out of the sale of surplus agricultural commodities either under sections 550 and 402 of the Mutual Security Act or under Title I of P.L. 480 (Agricultural Trade Development and Assistance Act of 1954).

By far the largest amount of American aid has been in the form of surplus commodity assistance under Title I of P.L. 480. On 29 August 1956 the first P.L. 480 agreement was signed between the US government and the Government of India, for the import of surplus commodities amounting to Rs. 111.43 crores in value. It was subsequently amended raising the total value to Rs. 168.86 crores. A supplementary agreement was signed in June 1958 for commodities worth Rs. 26.33 crores. Two more agreements were entered into, one in September 1958 and the other in November 1959 for Rs. 123.71 crores and Rs. 141.76 crores respectively. But by far the largest single commodity assistance was received in May 1960 when agreement was reached between the US government and the Government of India for a multi-year P.L. 480 assistance providing for the sale of 16 million tons of wheat and one million tons of rice valued over Rs. 600 crores.[8] Later the agreement was amended to include other commodities also such as cotton, tobacco and soyabean oil, thus raising the total P.L. 480 assistance under the agreement of May 1960 to Rs. 652.29 crores.

Under the P.L. 480 agreements the rupee equivalent of the dollar price of the surplus products plus 50 per cent of the shipping charges[9] is deposited by the Government of India in an account in favour of the US government. Out of these rupee resources the US government has given loans and grants to the Government of India for mutually agreed development projects. A portion of the rupee deposits, however, are retained by the US government for their own uses. Following the 'Cooley Amendment' to P.L. 480, part of the rupee resources is given in the form of loans to American

8. United States, *Report to Congress on Mutual Security Program (for the fiscal year 1960)* (Department of State, January 1961) 55.

9. Ocean freight differential arising from the requirement that United States flag vessels should be used is borne by the US government.

firms and their affiliates in India.

The total commodity assistance received so far under P.L. 480, that is in gross figures, has amounted to Rs. 1,113 crores. But it will be more appropriate to consider the quantum of 'aid' under P.L. 480, in terms of local currency loans and grants to the Government of India and also the loans under the Cooley Amendment, thus excluding that part of the rupee equivalent of P.L. 480 commodity sales which are actually retained for US Embassy uses. In reality the import of surplus commodities under P.L. 480, in the first instance, is a trade transaction under which the US government accepts payment in rupees. The 'aid component' of P.L. 480 commodity imports is only that part of the rupee resources which are made available for developmental purposes (see Table 23).

Out of the total surplus commodity imports under P.L. 480, Title I, amounting to Rs. 1,113 crores, the actual aid component amounted to Rs. 969.7 crores, the rest being reserved for the US government uses. A portion of the rupee funds retained by the US government for their own uses were diverted by the US government to Burma and Nepal in the form of third country currency assistance. Under this scheme Burma received Rs. 2.4 crores for importing Indian textiles during 1957. A sum of Rs. 8.2 crores was diverted to Nepal from US-owned rupee resources partly to aid Nepal's developmental programmes and partly to finance publication programmes under the direction United States Information Library in Nepal.

In addition to surplus commodity assistance under Title I of P.L. 480, aid from the US to the tune of Rs. 38.1 crores was available during the Second Plan period in the form of grants or donations under Title II and Title III of P.L. 480. Under Title II of the Act the US donates emergency assistance to countries abroad in the form of famine and other emergency relief supplies. Gift of food commodities to non-profit voluntary agencies is covered by Title III of the Act.

During 1958 and 1959 the US diverted to India third country currencies to the tune of Rs. 2.8 crores to finance the import of certain commodities. These third country cur-

Table 23

P.L. 480 (TITLE I) ASSISTANCE
(Rs. crores)

Agreement	Value of commodity imports	Allocation of Rupee proceeds: 'Aid' component: Loans to Government of India	Grants to Government of India	Cooley Amendment loans	Total	Retained for US uses
(1) First P.L. 480 agreement, 29 Aug. 1956 (as subsequently amended)	168.9	107.8	25.7	—	133.5	35.4
(2) Supplementary agreement, 23 June 1958	26.3	15.9	—	6.6	22.5	3.9
(3) Second P.L. 480 agreement, 26 Sept. 1958	123.7	61.8	17.9	31.0	110.7	13.1
(4) Third P.L. 480 agreement, 13 Nov. 1959 (as amended)	141.8	56.7	56.7	7.1	120.5	21.3
(5) Fourth P.L. 480 agreement, 4 May 1960 (as amended)	652.3	275.0	275.0	32.7	582.7	69.6
Total	1,113.0	517.1	375.3	77.3	969.7	143.3

Source: Government of India, *External Assistance, 1961,* 11. Figures may not add up due to rounding.

rencies, namely, Italian lire, French francs and Japanese yen, were part of the foreign currencies retained for US government uses and arising from the sale of American surplus commodities to these third countries. Other forms of economic assistance from the US during the Second Plan included the President's Asian Economic Development Fund[10] Loan amounting to Rs. 9.5 crores for the Orissa Iron

10. The President's Asian Economic Development Fund (AEDF) was established in the fiscal year 1956 by the decision of the Congress with the object of promoting regional economic development and cooperation among the Asian countries, generally friendly to the United States.

Ore project, the Rs. 5.9 crores loan from US Bank for Air India, and various grants from the Ford Foundation.

Total US aid available during the Second Plan period, including new authorisations during the Plan period and the undisbursed portion of the aid authorisations during the earlier Plan period, amounted to about Rs. 1,638 crores. P.L. 480 assistance is included in the above figure in terms of the gross value of the commodity imports. However, as pointed out earlier, that portion of the rupee resources which are retained for US government uses should be deducted from the gross figure to find out the actual 'aid' component of P.L. 480 imports. No doubt, even after making such adjustments, the total volume of US aid remained at a very impressive figure of about Rs. 1,494 crores. However, the estimated utilisation of these massive American aid was only about 50 per cent during the Second Plan period.[11]

For the Third Five Year Plan, fresh authorisations were made by the various foreign aid agencies of the US government during 1961-2. This included Export-Import Bank loans amounting to Rs. 15.6 crores for the import of machinery, loans from the DLF for a total of Rs. 47.6 crores, TCA

11. In the following table P.L. 480 assistance is given in terms of gross value of surplus commodities because figures for utilisation of the rupee proceeds in various development projects are not readily available. The figures for utilisation of P.L. 480 assistance, as shown in the annual government publications on external assistance, and also shown in the following table, refer to the actual imports out of total authorisations:

Table 24

UNITED STATES AID AUTHORISED DURING THE SECOND PLAN AND BALANCE FROM FIRST PLAN

(Rs. crores)

A. *Loans and credits to be repaid in dollar*	
1. Export-Import Bank loans for import of machinery*	102.6†
2. US Bank's loan to Air India	5.9
B. *Loans and credits to be repaid in rupee*	
3. Loans under TCA programme (excluding assistance under P.L. 665)	39.9
4. DLF	196.9
5. Asian Economic Development Fund loan for Orissa Iron Ore Project	9.5

grants to the tune of Rs. 6.8 crores, and donations under Title II and III of P.L. 480 totalling about Rs. 10.9 crores. Further, under the Agency for International Development (AID), the new organisational set-up of US foreign aid, a loan for Rs. 16 crores was extended during the year 1961-2. At the end of March 1961, it was announced that the US government had authorised two loans, to be channelled through US AID, to India and totalling about Rs. 57 crores. The first loan of Rs. 47.6 crores was to be used to finance imports of critically needed commodities, both agricultural and industrial. The second credit was for the Industrial Finance Corporation.

Inflow of public foreign capital from the United Kingdom was negligible during the First Plan period. The Second Plan period, however, witnessed a marked change in the foreign aid programmes of the British government. British entry into this field was dramatised by the agreement reached for the British credit amounting to Rs. 35.3 crores for the setting up of a steel plant at Durgapur. This consisted of Rs. 15.3 crores from Lazard Bros. and a credit of Rs. 20 crores under Export Credit Guarantee Department (ECGD) of the British government.

In 1957 and 1958 the UK government undertook a wide range of measures aimed at a substantial increase in its aid to Commonwealth and dependent countries. This affected

C. Grants	
6. TCA grants (excluding P.L. 665)	88.3
7. Ford Foundation	13.8
8. P.L. 480, Titles II and III	38.1
D. Other assistance	
9. P.L. 480 (gross)	1,113.0
10. P.L. 665 (gross)	26.8
11. Third Country currency assistance	2.8
Total	1,637.6

*Includes two loans to the Air India by the Export-Import Bank and the Boeing Company.

†Of this amount of Rs. 102.6 crores, Rs 23.8 crores has been earmarked for use of the projects included in the Third Plan outlay.

Note: Assistance under P.L. 480 and P.L. 665 are shown here on a gross basis representing the rupee credits raised against the value of goods received from time to time. It excludes loans and grants received by the Government of India out of P.L. 480 (Title I) and P.L. 665 funds.

the nature of the credits extended by the ECGD. The ECGD used to underwrite all the commitments made by private British firms in extending foreign credits. In 1957 it was agreed between the governments of United Kingdom and India that no further ECGD credits will be made for India without the prior authorisation of the business venture by the Government of India. It was also decided that future ECGD credits should be for projects of capital development in India. At the Commonwealth Trade and Economic Conference at Montreal on 22 September 1958 the UK Chancellor of the Exchequer introduced a four-point plan for larger Commonwealth assistance. The first point of this plan envisaged 'a new system of Commonwealth economic assistance loans' by which independent countries of the Commonwealth will be offered credits from the Export Credits Guarantee Department at a rate only one-fourth per cent above the rate at which the British government can borrow from the market.

The Government of United Kingdom extended a loan of 108 million dollars to India in 1958 through the mechanism of the ECGD. In the process of fulfilling the commitments made to the Government of India the British government, in effect, elevated the ECGD to the position of a British Export-Import Bank. Foreign aid on a government-to-government basis, it seems, has come to stay in the UK.

The British loan of 108 million dollars was described by the *Financial Times* (London), as 'a hard-headed and a useful piece of economic assistance'.[12] It was hard-headed for the British government because it cost less compared to the sizable running down of sterling reserves during the foreign exchange crisis of 1956-8. The sterling area could 'much better afford such a loan than it could afford the effect on the pound of any crisis for the rupee'.[13]

During 1961-2 India received for the Third Plan three ECGD credits to the tune of Rs. 13.3 crores, Rs. 40 crores and Rs. 6.7 crores, for the import of capital goods. Signing the agreement for a credit of Rs. 6.7 crores on 10 November

12. *The Financial Times* (London), 5 September 1958, 8:2.
13. *Ibid.*

1961, in New Delhi, Sir Paul Gore-Booth, the British High Commissioner in India, emphasised that 'despite some drastic cuts and curbs introduced by the UK Chancellor of the Exchequer to correct the imbalances in the British economy, the UK had not reduced the quantum of aid to developing countries, including India'.[14]

Apart from the credit for the Durgapur Steel Plant and the ECGD credits for the import of capital goods, British financial aid was available only to the India Oil Pipe Line project to the extent of Rs. 4 crores. British assistance was also forthcoming in the form of technical assistance in certain fields.

Table 25

PUBLIC FOREIGN CAPITAL FROM THE UNITED KINGDOM

(Aid authorised during the Second Plan plus balance from the First Plan)

(Rs. crores)

1. Lazard Bros. credit for Durgapur Steel Plant	15.3
2. ECGD I (credit for Durgapur)	20.0
3. ECGD II (credit for capital goods)	38.0
4. ECGD III (credit for capital goods)	25.3
5. ECGD IV (credit for capital goods)	13.3
6. ECGD V (credit for capital goods)	6.7
7. UK-India Oil Pipe Line	4.0
Total	122.6

It is important to note that the entire amount of British aid authorised during the Second Plan period, except for a small portion of the aid given to India Oil Pipe Line project, was utilised during the period itself.

Economic assistance under the Colombo Plan was available during the Second Plan period noticeably from Canada, Australia and New Zealand, Colombo Plan aid from the UK being negligible. The Government of Canada had authorised about Rs. 6.5 crores for assistance to India under the Colombo Plan in 1956. About Rs. 3.5 crores were earmarked for the Kundah hydroelectric project in Madras State. Another specific project associated with Canadian Colombo Plan assistance is the Canada-India Atomic Reac-

14. *The Statesman* (Delhi) 11 November 1961, 1:8.

tor in Trombay. In addition to assistance under the Colombo Plan, the Government of Canada advanced two wheat loans during the Second Plan period amounting to Rs. 11.5 crores and Rs. 4.2 crores respectively. Aid authorised by Australia and New Zealand during the 1956-61 under the Colombo Plan amounted to Rs. 8.1 crores and Rs. 3.1 crores.

For the Third Plan, the Colombo Plan countries authorised in 1961-2 aid amount to a total of Rs. 13 crores out of which the bulk, that is, Rs. 11.9 crores are from Canada. In addition, Canada also authorised in the same year Rs. 9.5 crores of aid for importing capital equipments for the Third Plan.

The list of India's creditor countries during the Second Plan period was not limited to the United States and the Colombo Plan countries. Two important capitalist countries, Japan and West Germany, entered the field of international aid in a substantial way reflecting the increasing maturity of capitalism in these countries. In addition, Switzerland and Norway also advanced aid for India's Second Plan amounting to Rs. 10.9 crores and Rs. 1.9 crores respectively in the form of grants.

Japanese assistance to India began in a modest way. It all started in 1951 when the Government of India entered into discussion with the Japanese mission, which visited India early that year, on the possibilities of developing small-scale industries in India and 'suggested to them that they might loan to us the services of a few Japanese experts to help us in organising small-scale industries here'.[15] Consequently, the Japanese government agreed to give technical assistance to India in this vital sector for placing it on a technically more efficient footing.

During the Second Plan period the Export-Import Bank of Japan advanced credits to India totalling Rs. 23.8 crores for the import of capital goods. Another project for which yen credit was available during the same period was the

15. Reply to question in Parliament by the Minister of Commerce and Industry on 3 April 1951 (*Parliamentary Debates*, P. I, vol. VII, No. 2, 2838-9).

Orissa Iron Ore project. Japan made available Rs. 3.8 crores in the form of supplier's credit at 6 per cent interest per annum.

At the Consortium meeting in May-June 1961, at Washington, the Japanese government announced their willingness to give assistance to the tune of Rs. 38 crores for the first two years of the Third Plan. Consequently, an agreement was signed on the 18 August 1961 with the Export-Import Bank of Japan and twelve other Japanese banks participating in the assistance programmes for the supply of the above credit.

Among the European countries West Germany has witnessed during the last decade a rate of growth in income which is comparable to that in many socialist countries. It is not necessary here to digress upon the factors contributing to the high rate of growth of the West German economy; but suffice it to note that the pattern of economic development in West Germany under monopoly capitalism has enabled that country to emerge as a potential competitor to the other advanced capitalist countries in the field of international economic aid. The increasing volume of West German aid to India during the last decade clearly illustrates this point.

West German aid programmes in India started with the credit agreement signed in 1955 for the setting up of the Rourkela Steel Plant. For this steel plant, designed to produce one million ingot tons of steel initially,[16] West Germany agreed to advance during the Second Plan period credit amounting to about Rs. 75 crores. This covered the entire foreign exchange cost of the project.

The manner in which the Rourkela Steel Plant has been set up is typical of parasitic monopoly capitalism. The West German combine of Krupp-Demag has been retained for 'consultation'. For this Krupp-Demag is to get fees totalling over 7 million dollars. The contract has actually been 'farmed out' to 35 German firms, along with a number

16. It has been decided to expand the capacity of the Rourkela plant to 1.8 million tons of ingot steel per year during the Third Plan period.

of Indian sub-contractors.[17]

On 25 October 1958, an agreement was entered into between the governments of India and West Germany for starting a prototype production-cum-training centre at the Okhla Industrial Estate. As the West German Commissioner R. Wollrath described it, the centre is 'unique inasmuch as it would give training and also produce prototypes'[18] of a variety of machines and tools which would later be available for small industrial units for adapting on a commercial basis.

During the Second Plan period India received from West Germany a total of about Rs. 47 crores as credits for the import of machinery and capital goods. In addition, a new credit of Rs. 11.2 crores was given in January 1961 for Rourkela prolongation.

Table 26

ECONOMIC ASSISTANCE RECEIVED FROM WEST GERMANY DURING SECOND PLAN

(Rs. crores)

A. *Loans to be repaid in foreign currency*	
1. Credit for Rourkela Steel Plant	75.5*
2. Credit for import of machinery, etc.	19.0
3. Credit of May 1960 (capital goods)	14.1
4. Credit of November 1960 (capital goods)	14.1
5. Credit of January 1961 (Rourkela prolongation)	11.2
B. *Grants*	
Okhla Industrial Estate and I.I.T., Bombay.	2.1
Total	135.1

* The undisbursed amount of this credit has been raised by 5 per cent to take into account the revaluation of DM in March 1961.

At the Consortium meeting in Washington during May-June 1961, West Germany announced credits to India totalling an amount which was second only to that from the United States. Between April and September 1961, three credits were received for Rs. 27.4 crores, Rs. 11.9 crores

17. See Wilfred Malenbaum, *East and West in India's Development* (Washington, 1959) 48.
18. *Hindustan Times* (New Delhi) 25 October 1958.

and Rs. 20 crores respectively. The first loan was meant for refinancing payments under an earlier credit for Rourkela Plant, while the other two credits were in the nature of balance of payments assistance.

The framework of the Aid India Consortium has been instrumental not only on increasing the volume of foreign aid from the capitalist countries, but also in enlarging the number of India's creditors. With the addition of the new members such as Italy, Netherland, Belgium and Australia, the Consortium has become an important lever in the co-ordination of foreign aid policies and programmes of the capitalist countries.

At the Consortium meeting in May-June 1961, the French government announced a credit to India of Rs. 14.3 crores to finance the import of capital goods from France during 1961-3. About Rs. 4 crores have been set apart for petroleum explorations and development in India. Consequently a project agreement was signed on the 12 September 1961 between the Oil and Natural Gas Commission and the Institute Francis Du Petrole (IFP) of France. In addition to financial assistance, France has also initiated a technical assistance programme with India. Under the Indo-French Technical Cooperation Agreement, Indians are being trained in France in various branches of technology.

Aid for the Third Plan to the extent of Rs. 21.4 crores was made available by Italy following the deliberations of the Consortium. On the 29 August 1961, an agreement was entered into between the Government of India and the Ente Nazionale Idrocarburi (ENI) of Italy. Another entrant to the list of India's creditor countries, Switzerland, undertook, by an agreement signed on the 30 July 1960, between the governments of India and Switzerland, to open transfer credits to the extent of 100 million Swiss francs or about Rs. 10.9 crores. These credits are provided by a consortium of Swiss banks.

A significant development in the field of India's foreign economic relations during the Second Plan period was the emergence of the Soviet Union and other socialist countries as an important source of economic assistance to India.

The socialist countries started their programmes of aid to underdeveloped countries only by 1954. Beginning from a very paltry figure the total loans and credits offered by the socialist countries reached the noticeable figure of 7.4 billion roubles in 1959.[19] By the middle of 1960 there were about 22 countries in the underdeveloped world which were receiving economic assistance from the socialist countries. By that year the Soviet Union itself had given assistance to underdeveloped countries in the construction of more than 100 industrial enterprises and about 110 other units. Among these projects were 9 iron and steel mills, 11 machinery manufacturing plants, 12 thermal and hydroelectric plants, 6 oil refineries, 13 coal and ore mines, and 7 enterprises in the chemical industry.[20]

Soviet economic assistance to India started at a time when new priorities in favour of basic and heavy industries were being worked out for developmental planning in India. In the iron and steel sector the deficiency of domestic production was particularly visible. In 1955 India was producing only 1.26 million tons of steel or 11 lbs per head of population as against 125 million tons or 1180 lbs per head in the United States and 20 million tons or 572 lbs per head in the United Kingdom. Thus the emphasis on iron and steel industry during the Second Plan was a decisive step in the direction of deliberate industrialisation, and the strengthening of India's economic independence.

In September 1954 the Soviet government expressed its willingness to provide economic assistance to India in setting up an iron and steel plant in India. Following the report of a Soviet survey team, negotiations between the two governments took place, culminating in the agreement signed on the February 1955 for the Bhilai Steel Plant. The Soviet credit for Bhilai came to Rs. 63.07 crores. Construction of the steel plant proceeded at a remarkably quick pace and by October 1959 it was possible to start steel pro-

19. United Nations, *World Economic Survey*, 1960 (New York, 1961) 124.

20. A. Smirnov, 'Soviet Technical Assistance in the Construction of Plants Abroad', trans. in *Problems of Economics*, II, 9 (January 1960) 58.

duction at Bhilai. In the beginning of 1961 all units of the steel plant had started functioning and the original steel capacity of one million tons was reached.

In November 1957 the Soviet Union agreed to give another loan of Rs. 59.5 crores for industrial projects. This aid programme covered a number of projects such as the heavy machinery plant in Ranchi, the plant to make mining equipment at Durgapur, the thermal power plant in Neyveli, and a number of mines in the Korba coal fields.

The heavy machine building plant at Ranchi has a capacity, at the first stage, to produce various types of equipments to the extent of 45,000 tons per year. The items of machinery to be manufactured at this plant include equipments for coke-chemical works, blast furnace, rolling mill, steel making, and for other heavy industries. Provision has been made for the enlargement of the plant's capacity to 80,000 tons of machinery items per year as a result of which further items of machinery such as equipments for oil-drilling plants, excavators, mine and forge press equipment, will also be turned out by the plant.

The coal mining machinery plant at Durgapur has a capacity of 30,000 tons of machinery items per year, covering equipments such as coal-cutters and loading machines, electric locomotives for mines, mine-hoisting machines, hauling wenches and mine-pumps. The thermal power plant at Neyveli has a capacity of 250,000 kw. The importance of this project lies in the fact that Soviet assistance is directed here towards the supply of power with a cheap resource, namely, lignite. The capacity of the Neyveli power plant has been proposed to be increased to 400,000 kw by a new agreement in 1960. The Soviet Union has also agreed to build a new thermal power plant at Singaruli in Uttar Pradesh with a capacity of 250,000 kw.

The development of the Korba coal fields with a capacity of 2.5 million tons of coal per year and the setting up of a central mechanical repair shop for reparing coal mine equipments have been provided for under the programme of Soviet assistance for industrial projects in India. Another industrial project for which Soviet assistance has been made

available is the special glass factory with a capacity for manufacturing 250 tons of ophthalmic glass per year.

An important sector for which Soviet economic assistance was available during the Second Plan was the manufacture of drugs and pharmaceutical products. This sector was dominated by private companies, mainly British and American monopoly interests. The manufacturing units they established in India were largely units processing the drugs imported from their parent companies abroad. Soviet assistance facilitated the breaking of this foreign monopoly hold on the supply of drugs in India.

Soviet willingness to help India in the creation of a national drugs industry opened up the prospects of manufacturing in India, with indigenous materials, a number of products such as penicillin, streptomycin, and other antibiotics, important vitamins and anti-malarials. A team of Indian and Soviet experts studied the possibility of manufacturing various drugs and pharmaceutical products in India using indigenous products. The final report of the joint team which was submitted to the Government of India in October 1958, clearly indicated the feasibility of manufacturing a large number of these products in India.

An agreement was entered into in May 1959 by which the Soviet Union gave assistance to India to the tune of Rs. 9.5 crores for the establishment of various manufacturing units as part of an integrated project in the public sector to produce pharmaceuticals, drugs and surgical instruments. The units covered by this assistance include the antibiotic project at Rishikesh in Uttar Pradesh, the synthetic drugs project at Hyderabad, the surgical instruments project near Madras and the phytochemical project at Neriamangalam. The total production capacity of these units will be about 1,500 tons per year. In addition to financial assistance in the erection of these units, the Soviet Union has also agreed to provide technical training to about 400 Indian medical men in the various medicine manufacturing lines.

Aid from the socialist countries has been of immense significance in one of the most strategic sectors of the eco-

nomy, namely, petroleum. The search for oil in our own soil started with the exploration of Western private oil companies; but it was only with the aid from socialist countries did we succeed in building a nucleus of an independent national petroleum industry.

During November 1955-April 1956, a group of experts from the Soviet Union visited India and recommended the starting of oil exploration in the Punjab and Rajasthan and an extended programme of geophysical and geologic surveys in various parts of the country. The report of this team helped in the formulation of a comprehensive government programme for oil exploration during the Second Plan with a view to establishing a national oil industry. Up to the end of 1959 the Soviet Union had supplied equipments for geophysical survey amounting to the value of over 13.5 million roubles.

In addition to assistance in the field of oil exploration, the Soviet Union has provided aid to the tune of Rs. 11.9 crores for setting up India's second refinery in the public sector at Barauni in Bihar.[21] Soviet Union is to provide assistance also to the medium-sized refinery to be set up at Cambay under the Third Five Year Plan.

Assistance from the Soviet Union has been almost en-

Table 27

SOVIET ASSISTANCE AVAILABLE DURING SECOND PLAN PERIOD

(Authorisations during the Second Plan and balance from the First Plan)

(Rs. crores)

A. *Credits*	
1. Credit for Bhilai steel plant	64.7
2. Credit for industrial enterprises	59.5
3. Credit for manufacture of drugs	9.5
4. Credit for Barauni Oil Refinery	11.9
5. Credit for Third Plan	178.6
6. Credit for Third Plan	59.5
B. *Grants*	
Agricultural machinery and equipment for IIT, Bombay	1.2
Total	384.9

21. The first refinery in the public sector is at Nunmati in Assam set up with the help of Rumanian aid.

tirely in the industrial sector. But the relatively insignificant amount of about Rs. 1 crore of assistance in the form of grants for the model state farm at Suratgarh has already achieved results which cannot but have significant implications on the future pattern and growth of Indian agriculture.

The credits authorised by the Soviet Union for the Third Plan amounting to a total of Rs. 238 crores cover a wide variety of projects such as doubling the capacity of the Bhilai Steel Plant and the Ranchi Heavy Engineering project, expansion of the mining machinery plant at Durgapur, the Korba Thermal Power station and the Neyveli Power plant, the completion of the oil refinery at Barauni, and for the Heavy Electrical Plant at Ranipur, the Precision Instruments plant at Kotah and in Kerala and the Thermal Power station at Singaruli.

The complete orientation of socialist aid towards industrialisation based on key industries such as iron and steel, and machine-building plants is discernible not only in Soviet aid to India but also in the assistance received from other socialist countries. Under an agreement entered into in November 1959 the Government of Czechoslovakia has authorised credits for the Third Plan amounting to about Rs. 23 crores for the import of machinery and equipments. The projects covered by this aid programme include the Heavy Foundry Forge Plant and the Heavy Machine Tools Building Plant, both at Ranchi, and a Heavy Electrical project. The Foundry Forge Plant is to serve as a metallurgical base for the Machine Tools Building plant and, thus, should be considered as part of an integrated project. The production capacity of the Heavy Machine Tools Building plant is to be 10,000 tons of heavy machine tools per year in the first stage of operation and is to be doubled in the second stage. The Heavy Electrial project actually consists of two plants, one a Heavy Power Equipment Plant at Ramachandrapuram near Hyderabad, and the other a high Pressure Boiler Plant near Tiruchi in Madras State.

In addition to assistance for these key industries, Czechoslovakia has also been helping India in the setting up of

2 cement factories, 2 power stations, one plant for the manufacture of cycle-chains, and 3 sugar mills. In the manufacture of sugar plant machinery Czechoslovakia entered into collaboration with Messrs Walchand Nagar Industries and has helped in turning out substantial amounts of machinery using 80 to 90 per cent of locally manufactured components.

The economic assistance authorised by other socialist countries include Rs. 19 crores from Yugoslavia in January 1960 for Hydroeletric projects and Rs. 14.3 crores from Poland in May 1960. The major portion of the credit extended by Poland was for the import of machinery and other equipment for various industrial projects in India under the Third Plan. The projects for which assistance is made available include the Jharia deep coal mining project, coal washery at Karanpura, a project for manufacturing motor cycles and the expansion of Praga Tools Corporation.

Assistance from Rumania for the development of a national petroleum industry in India must be noted. An agreement was signed between the governments of India and Rumania on 20 October 1958, under which Rumania agreed to provide aid to the Government of India for oil refineries. Rumania, with its century old experience in oil exploration, offered much better terms for the construction of a refinery than what had been agreed upon between the Government of India and Caltex for the refinery at Visakhapatnam. While the Caltex agreed to give us a refinery of 650,000 tons at a cost of about Rs. 15 crores, the Rumanian aid was for a refinery of 750,000 tons at a cost of about Rs. 9 crores. The fact is that Caltex, using its monopolistic power, had charged a much higher price.

The significance of socialist aid for India's oil industry lies in the fact that it broke, for the first time, the monopoly hold of foreign private companies on our petroleum industry. The reduction in the bargaining power of the foreign oil monopolies was evidenced by the decision on the part of the foreign oil companies to reduce the selling price of petrol immediately following the news that gas

was struck at Jwalamukhi by the Rumanian drill.

During the Second Plan period India received substantial loans from international institutions, largely from the World Bank and to a small extent from the International Development Association. Compared to the First Plan period there was a marked increase in the flow of financial resources from the IBRD, both for the public and private sectors.

The major share of World Bank loans to the public sector went into railways. Out of the total aid of Rs. 186 crores from the World Bank available for the Second Plan 75 per cent consisted of four loans for railway development. The rest of the available World Bank resources were accounted for by two loans for the Damodar Valley Corporation amounting to Rs. 13.5 crores, loans for port development in Calcutta and Madras amounting to a total of Rs. 20.5 crores and for Air India International and the Koyna hydro-power projects to the tune of Rs. 2.7 crores and Rs. 8.9 crores respectively. It is important to note that the World Bank loans to the public sector during the Second Plan period, as in the case of the earlier Plan, were unduely influenced by the Bank's project preference for transport and other economic overheads.

The direction of World Bank loans in the private sector, on the other hand, was different. Heavy industries run by private enterprise are qualified for loans from the Bank. The two large private sector iron and steel concerns, the TISCO and the IISCO, received substantial loans from the World Bank during the Second Plan period. These two companies between themselves accounted for about 45 per cent of the total aid available for the private sector (see Table 28).

The World Bank authorised in 1961-2 loans amounting to a total of Rs. 33.8 crores for the public sector in the Third Plan. This consisted of Rs. 23.8 crores for railways and Rs. 10 crores for the Calcutta Port. Loans authorised in the same year for investment in private sector industries during the Third Plan period included Rs. 9.3 crores for IISCO, Rs. 9.5 crores for ICICI and Rs. 16.7 crores for the coal industry.

Table 28

IBRD LOANS AVAILABLE DURING SECOND PLAN

(Aid authorised during Second Plan and balance from the First Plan)

(Rs. crores)

I. *Public Sector : Total*	*186.1*
1. Railways — II	42.9
2. Railways — III	40.5
3. Railways — IV	23.8
4. Railways — V	33.3
5. DVC — II	3.0
6. DVC — III	10.5
7. Koyna	8.9
8. Air India International	2.7
9. Calcutta Port	13.8
10. Madras Port	6.7
II. *Private Sector : Total*	*160.1*
1. IISCO — I	11.1
2. IISCO — II	9.5
3. TISCO — I	35.7
4. TISCO — II	15.5
5. Trombay — I	4.5
6. Trombay — II	4.7
7. ICICI — I	4.8
8. ICICI — II	4.8
9. ICICI — III	9.5
Grand total	346.2

Compared to other member-countries, India has received the largest number of loans from the World Bank. The loans received by India up to the end of 1961 amounted to over 11 per cent of the total loan disbursements of the World Bank to member-countries.

The beginning of the Third Plan witnessed a diversification of India's sources of international institutional aid. Notable among the new organisations is the International Development Association (IDA). The IDA, an affiliate of the World Bank[22], came into existence on 24 September 1960 with the objective of aiding development projects of high priority at interest and repayment conditions which do not entail heavy burdens on the recipient country's balance of payments. Three loans were anthorised by the IDA for

22. Even though the IDA is administered by the officers and staff of the IBRD, it has its own funds and is legally a separate entity.

India in 1961-2 amounting to a total of Rs. 51 crores consisting of Rs. 8.8 crores for power projects, Rs. 13.6 crores for agricultural development and Rs. 28.6 crores for the construction of national highways. The credit agreement for the national highways signed on 21 June 1961 cover half the cost of improving India's national highways during the first three and a half years of the Third Plan.[23]

The quantum of public foreign aid received by India from foreign governments and international institutions during the Second Plan period clearly indicates the fact that we have been successful in mobilising external resources to a level higher than what even the most optimistic estimates had suggested at the beginning of the Plan.

The total volume of external aid received so far, however, is not identical with the actual disbursements or the utilisation of the aid. There is a wide gap between authorisation and utilisation—a gap which is staggering in view of the difficulties with which these resources have been mobilised.

Table 29

DEGREE OF UTILISATION OF FOREIGN AID DURING THE FIRST PLAN

(Rs. crores)

Countries	*Assistance authorised*	*Assistance utilised*	*Balance*	*Degree of utilisation* (3) *as percentage of* (2)
(1)	(2)	(3)	(4)	(5)
United States	235.0	163.0	72.0	69.2
Canada	32.3	19.7	12.6	61.0
Australia	11.1	5.2	5.9	46.9
Other countries	2.4	0.6	1.8	75.0
Total	280.8	188.5	92.3	67.1

During the First Plan period out of the total authorisations of about Rs. 281 crores only about Rs. 189 crores were actually utilised, thus leaving a balance of Rs. 92 crores to be spent during the Second Plan period. The overall degree of utilisation thus worked out to 67.1 per cent. A

23. International Development Association, *First Annual Report, 1960-61,* 8.

countrywide break-down of the data is presented in Table 29.

The performance record of the Second Plan in the matter of utilisation of foreign resources was poorer than that of the previous Plan. Only a little over 57 per cent of the total authorisation for the Second Plan was actually utilised up to the end of the Plan period. Apart from the complete utilisation of Norwegian aid of Rs. 1.9 crores and the Candadian Wheat Loan for Rs. 15.7 crores and the near complete utilisation of British credits totalling about Rs. 122 crores, the picture was one of gross under-utilisation of available resources.

Table 30

ASSISTANCE AUTHORISED FOR THE SECOND PLAN AND UTILISED DURING THE SECOND PLAN PERIOD*

(Rs. crores)

Countries	*Assistance authorised for Second Plan and balances from First Plan*	*Assistance utilised during Second Plan*	*Balance at the end of Second Plan*	*Degree of utilisation, (3) as percentage of (2)*
(1)	(2)	(3)	(4)	(5)
United States	1637.6	822.1	815.5	50.2
USSR	146.8	74.1	72.7	50.5
West Germany	136.0	120.3	15.7	88.5
United Kingdom	122.6	121.8	0.8	99.3
Colombo Plan countries	82.9	71.1	11.8	85.8
Canada (Wheat Loan)	15.7	15.7	nil	100.0
Japan	27.6	16.0	11.6	58.0
Norway	1.9	1.9	nil	100.0
Total	2171.1	1243.0	928.1	57.3

* Assistance authorised during the Second Plan, but earmarked specifically for the Third Plan are omitted in this table.

Thus a substantial sum of about Rs. 928 crores of foreign aid which was made available for the Second Plan was carried over to the Third Plan. In addition, a large sum including DLF loan for the Third Plan amounting to about Rs. 130 crores and the Soviet credits for the Third Plan totalling about Rs. 238 crores had already been authorised

before the end of the Second Plan, thus providing a considerable balance of foreign resources for the Third Plan. The shortfall in utilisation of foreign aid has highlighted the entire question of India's absorptive capacity and the rigidities inherent in the very nature of foreign aid from certain countries.

For an explanation of the wide gap between authorisation and utilisation, one should look first into the ineffective absorptive power of the planning machinery in India. Very often, the considerable delays between the signing of the loan agreements and their actual utilisation is due to inexcusable delays on the part of the planning authorities in the execution of the development projects for which loans were contracted. The time taken for finalising the development projects, the delay in preparing specification for imported machinery and such other deficiencies of economic administration needs immediate remedy.

To a certain extent, no doubt, India's inability to utilise fully the resources committed to it by the lending countries has been due to the devious and intricate procedures laid down by some of the foreign governments for the utilisation of the loans. The procedure of tying of loans reduces the flexibility of the investment programmes undertaken by India. For instance, the Development Loan Fund places primary emphasis on the financing of goods and services of American origin whenever the loan is intended for financing the foreign exchange costs of the development projects. Under the 'Buy American policy', introduced in October 1959, the DLF would place 'primary emphasis on the financing of goods and services of US origin'[24] It is true that, in certain cases, the DLF has relaxed this provision, but the 'Buy American' bias is basic to its policy. Similarly, the Export-Import Bank of Washington generally gives credit only to finance purchases of goods manufactured in the United States.

The tying of loans is in many cases positively harmful to the recipient country. It was estimated that in 1955 and 1956

24. N. 8, 82.

American machinery was priced about 25 to 50 per cent higher than similar machinery from the United Kingdom, Germany, Japan, Sweden and Switzerland. The price differential between American goods and similar goods available in the other foreign countries is a disincentive for the utilisation of American tied loans. According to George Rosen, this is the main reason why Indian firms are not esthusiastic over American loans that have 'tied purchase' requirements.[25]

Another element of rigidity in utilisation is introduced by the allocation criteria adopted by some of the lending countries. For instance, the United States Export-Import Banks extends loans only for specific purposes. This means that disbursements of the Bank loans will be made only on the basis of satisfactory evidence that the purposes for which the loan was made will be realised.[26] The DLF extends aid generally on projects rather than programme basis. The Mutual Security Act of 1957 which lays down the guiding principles of the DLF authorised the President of the United States to make loans from the DLF taking into consideration, among other things, 'the economic and technical soundness of the activity to be financed.'[27] It is true that recently the DLF has extended assistance to India for the import of non-project commodities, that is, for meeting the foreign exchange difficulties. A large part of American assistance, however, has been tied to specifications regarding projects qualifying for aid.

The 'specific project' approach is an essential ingredient of the lending policy of the International Bank for Reconstruction and Development. Under the provisions of the articles of agreement, 'loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development'.[28] The

25. George Rosen, 'Problems of Private Investment in India by American Firms', *American Trade with Asia and the Far East* (Wisconsin, 1959) 127.
26. Export-Import Bank of Washington, *General Policy Statement* (Revised, 1 August 1947) 5.
27. US Public Law 85-141, 85th Congress, 1st Session, 14 August 1957.
28. International Bank for Reconstruction and Development, *The World Bank: Policies and Operations* (Washington, 1957) 40.

specific projects are determined by the Bank in relation to the 'appropriate investment priorities' which the Bank wants the recipient country to adopt. Thus, very often, the World Bank is prepared to give loans for specific projects which have a very low priority for the borrowing country.

If, instead of tying loans to particular projects, they were available for a wide range of projects within a broad development programme, India and other recipient countries would have found it easier to make the best use of the available resources. The project criterion does not take into account the immense possibilities of resource substitution.

One of the ways in which the lending countries can improve the recipient country's ability to absorb foreign loans is to extend 'soft' loans and loans repayable in the recipient country's own currency. Since soft loans, by definition, are loans the repayment of which is dependent on the future payments ability of the recipient country, the problem of utilisation becomes far less rigid. Loans with a maturity of, say, 15 to 25 years and carrying a very low rate of interest, obviously pose very little problem for the recipient country in its attempts at complete absorption and utilisation. In this category we may also include loans which are generally lent for a relatively short period, but which, by mutual understanding, is expected to be re-lent to the recipient country from time to time until the country's payments position has improved substantially. Loans repayable in local currency is again a type of soft loan. To the extent to which the soft loans were originally lent by the creditor countries with the expectation that ultimately part of the loans may have to be written off, 'soft loans are in effect contingent part-grants.'[29]

A study of the character of aid from the two important group of creditor countries, the capitalist and socialist, highlights certain essential elements of differentiation. In the case of aid from the United States and other capitalist countries, grants have accounted for a substantial share of the

29. Rosenstein-Rodan, n. 1, 224.

total economic aid. This was particularly true in India's First Five Year Plan as can be seen from the following table:

Table 31

EXTERNAL ASSISTANCE FROM FOREIGN GOVERNMENTS DURING THE FIRST PLAN PERIOD

(Rs. crores)

Countries	*Amount authorised*		
	Loans	*Grants*	*Total*
1. United States	117.7	117.3	235.0
2. United Kingdom	—	0.4	0.4
3. Canada	—	32.3	32.3
4. Australia	—	11.1	11.1
5. New Zealand	—	1.7	1.7
6. Norway	—	0.3	0.3
Total	117.7	163.1	280.8

Thus, during the First Plan period the only foreign country which gave aid to India on a loan basis was the United States. The share of grants in the total US aid to India was still as high as 50 per cent.

The character of aid underwent some noticeable changes during the Second Plan period. With the creation of the Development Loan Fund, economic development assistance of the US was placed on a loan basis, thus making 'a basic shift away from earlier policies under which assistance had largely been provided in the form of grants'[30] In spite of the increased emphasis placed on loans, US foreign aid programmes are still carried on in substantial magnitude in the form of outright grants. On other hand, grants constitute only an insignificant portion of aid from the socialist countries.[31] Socialist aid is almost entirely in the form of long-term loans and short-term credits.

It is true that since the burden of repayment and servicing of debt is totally absent in the case of outright grants, foreign grants or gifts have an obvious economic advantage

30. N. 8, 79.

31. In the total international aid given by the socialist countries, only about one per cent is in the form of grants or gifts. Even this has been limited largely to Soviet aid to China.

for the recipient countries. But from the wider interests of the recipient country the acceptance of foreign gifts has certain implications. Even assuming that the donor country gives the grants in the most disinterested way and without exhibiting, intentionally or unintentionally, the usual patronising attitude of a giver, the acceptance of the grants is likely to impair the self-respect of the recipient. For an independent and proud nation, the acceptance of charity, or grants which are likely to be interpreted by the people as charity, is sure to create political irritants.

The emphasis on loans and grants by the socialist and capitalist countries respectively is to be explained by the differences in the foreign aid philosophy of the two groups of countries. For the United States and other advanced capitalist countries, foreign aid involves a sublimation of their essential self-interest in the form of an act of philanthropy. They seem to abide largely by Polonius' admonition that 'loan oft loses both itself and friend'. On the other hand, the socialist countries take the position that real aid lies in the expansion of normal business operations and economic ties of a long-term character based on mutual benefits and equality. And their essential self-interest, thus conceived, coincides with the interests of the recipient countries.

The essential self-interest of the socialist countries is the expansion of long-term economic relations and friendship with the non-socialist countries, particularly with the underdeveloped and uncommitted nations in the capitalist world. And long-term economic relations and friendship can be built up not through one-sided charity, but by continued mutual benefit and mutual obligations through long-term credit and trade agreements. Commercial credits and loans on favourable terms enable the recipient countries not only to respond enthusiastically to the gesture of friendship shown by the donor country but also to be prudent in the matter of utilisation of the aid, for it entails the responsibility of repayment and debt servicing.[32]

32. Feodor Bystrov, 'International Credit Relations of the USSR', *Vneshnaya Torgovlya* (Moscow) 9, 1961, reproduced in *International Socialist Miscellany* (New Delhi, 1963) No. 4, 81.

In general, it is possible to differentiate between aid from capitalist countries and aid from the countries in the socialist system on the basis of the differences in their repayment and servicing terms and conditions. To the extent to which aid from the capitalist countries is available in the form of grants the problem of repayment and interest payment is avoided. But the major part of the loans and credits advanced by the capitalist countries carries with it relatively heavy burdens of servicing and liquidation of obligations. The terms and conditions attached to loans and credits from the socialist countries, on the other hand, have generally been extended on more favourable terms.

The interest charged on public loans from the United States varies according to the nature of the loans. The Wheat Loan of 1951 carried with it a low interest rate of 2.5 per cent. On the other hand, the rate for the loans from Export-Impor Bank and that from the US banks has been as high as 5 to 6 per cent (see Table 32).

The policy of the DLF has been to charge a low rate of 3.5 per cent for loans meant for investment in public utilities; but the rate in the case of loans authorised for industrial projects has been as high as 5.75 per cent. The agreements regarding rupee loans under PL 480 involve a peculiar system of differential rates, one if the repayment is made in dollars and the other if it is in the local currency. In the case of the two agreements signed in 1957 and 1958 there is a range of one per cent between the minimum and maximum rates.

The variations in the interest rates charged on United States public capital, with some loans having relatively low rates and others carrying higher rates, are not entirely due to the differences in the direction of the loans, that is, the purposes for which resources are invested. It is partly also a reflection of the varying degrees of pull exerted by different interests in the US aid machinery. At the one extreme the protagonists of 'competitive coexistence' argue for a liberal aid policy to the developing countries with 'long-maturity, low interest rate' loans as the pivot of the economic struggle against the socialist bloc. At the other

Table 32

INTEREST RATES ON PUBLIC LOANS FROM THE UNITED STATES

	Date of loan	*Amount involved (Rs. crores)*	*Rate of interest per annum (per cent)*
1. *Wheat Loan*	June, 1951	90.3	2.5
2. *US Banks for Air India International*			
i) Loan — I	31-1-57	11.2	5.0
ii) Loan — II	20-5-60	1.2	6.0
iii) Loan — III	1-5-61	2.4	5.75
3. *Export-Import Bank*			
i) Credit	12-6-58	71.4	5.25
ii) Credit	January, 1961	23.8	5.75
4. *D.L.F.*			
i) Loan No. 2	23-6-58	30.0	3.5
ii) Loan No. 3	23-6-58	35.0	5.25
iii) Loan Nos. 12. 13A and 21	24-12-58	63.0	3.5
iv) Loan No. 13B	24-12-58	22.0	5.5
v) Loan No. 40	24-12-58	15.0	5.75
vi) Loan No. 78	27-7-59	20.0	5.75
vii) Loan Nos. 120, 121, 122, 125, and 130	30-6-60	66.1	3.5
viii) Loan No. 131	30-6-60	13.1	5.75
ix) Loan No. 118	5-12-60	10.0	5.0
x) Loan Nos. 140, 141 and 151	5-12-60	54.1	3.5
xi) Loan Nos. 157 and 159	5-12-60	50.0	5.75
5. *Rupee Loans under P.L. 480*†			
i) First loan	28-6-57	107.4	3.0 to 4.0 §
ii) Second loan	3-11-58	15.9	4.0 to 5.0 §
iii) Third loan	27-4-59	61.8	3.5
iv) Fourth loan	15-4-60	49.2	4.0

† The terms and conditions of the loans made under P.L. 480 Commodity Agreements are decided by subsequent loan agreements.

§ The lower and the higher rates refer to the rates which will be charged if the amount is repaid in dollars and in rupees respectively.

extreme, the true nature of monopoly capitalism emerge, clamouring for higher rates to include 'a premium for the risk of debtors' bankruptcy'. Since part of the resources channelled under the auspices of the US agencies originally come from American private monopoly concerns, for in the case of US banks' loans for Air India International, the law of maximum profit is not without its operational validity.

The fact that the most resourceful creditor country in the

capitalist world, the United States, can afford to give some loans to underdeveloped countries at relatively low interest charges for the sake of overall American foreign policy objectives, does not mean that the less fortunate members of the Consortium can repeat the same performance. Except in the case of the West German loan authorised in September 1961 which carries a low rate of interest of 3 per cent, all the loans from the junior partners of the Consortium have a relatively high rate of between 5 and 7 per cent.

Table 33

INTEREST RATES ON PUBLIC LOANS FROM CAPITALIST COUNTRIES (OTHER THAN THE UNITED STATES)

	Date of loan	*Amount involved (Rs. crores)*	*Rate of interest per annum (per cent)*
1. *United Kingdom*			
i) Lazard Bros. credit for Durgapur Steel Plant	5-1-57	15.3	1.0 above bank rate
ii) E.C.G.D. — I, for Durgapur Steel Plant	30-6-58	20.0	5.38 to 5.75
iii) E.C.G.D. — II (capital goods)	20-12-58	38.0	4.75 to 5.5
iv) E.C.G.D. — III (capital goods)	25-11-59	25.3	5.13 to 6.13
v) U.K.-India Oil pipe line	23-6-59	4.0	4.38 to 6.25
2. *West Germany*			
i) Credit for Rourkela steel plant	26-2-58	75.5	6.3
ii) Credit for import of capital goods (2 loans)	6-1-59 and 15-11-60	33.1	5.5
iii) Credit for import of capital goods	27-5-60	14.1	6.5
iv) Rourkela prolongation	30-1-61	11.2	5.75
v) Rourkela prolongation and balance of payments assistance	29-4-61	30.3	5.5
vi) Balance of payments assistance	14-9-61	20.2	3.0
3. *Japan*			
i) Export-Import Bank Credit	4-2-58	23.8	5.75
ii) Export-Import Bank Credit	18-8-61	38.1	6.0
iii) Credit for Orissa Iron Ore project	8-3-60	3.8	6.0
4. *Italy*			
Credit for petroleum industry	29-8-61	21.4	6.0
5. *Switzerland*			
Credit from Swiss banks	30-11-60	10.9	3.75 above bank rate

The charges on World Bank loans have not been much different. Even though the rate charged by the Bank at a given moment of time is uniform for all borrowers, the rate varies from time to time according to the estimated cost of such borrowing. And such variations are governed generally by the interest rate fluctuations in the US market. The procedure of determining the exact interest rate for any given loan, irrespective of whether the loan is made out of the Bank's capital subscription and earnings or out of borrowed founds, is, firstly, to calculate the cost of borrowing money of similar maturity in the American market. Over an above this, the World Bank includes in the rate a commission of one per cent for augmenting its reserve funds and another charge of one-fourth of one per cent, mainly to cover administrative expenses.[33] The rates charged on loans to India, for projects both in the private and public sectors, have generally varied between 4 per cent and 5 per cent as can be seen from the following table:

Table 34

INTEREST RATES ON IBRD LOANS TO INDIA

Project	*Loan number*	*Date of loan agreement*	*Amount involved (Rs. crores)*	*Rate of interest per annum (per cent)*
1. Railway rehabilitation	17	18-8-49	15.6	4.00
2. Agricultural development	19	29-9-49	3.4	3.50
3. Electrical power development	23	18-4-50	8.0	4.00
4. DVC	72	23-1-53	18.5	4.88
5. IISCO	71	18-12-52	13.9	4.75
6. IISCO	159	20-12-56	9.5	5.00
7. Tata group of hydro companies	106	19-11-54	6.6	4.75
8. ICICI	109	14-3-55	4.8	4.64
9. TISCO	146	26-6-56	35.7	4.75

In direct contrast to the rate pattern of loans from the capitalist countries is the unformly low rate charged by the socialist countries on the loans and credits advanced by

33. N. 28, 73.

them. Except in the case of the Yugoslav credit which involves a rate of interest of 3 per cent, all the credits from the socialist countries carry a uniform rate of 2.5 per cent per annum.[34]

Table 35

INTEREST RATES ON LOANS AND CREDITS ADVANCED BY SOCIALIST COUNTRIES

	Date of loan	*Amount of loan (Rs. crores)*	*Rate of interest per annum (per cent)*
USSR			
1. Credit for Bhilai Steel Plant	2-2-55	64.7	2.5
2. Credit for industrial projects	9-11-57	64.7	2.5
3. Drugs projects	29-5-59	9.5	2.5
4. Oil refinery	28-9-59	11.9	2.5
5. Third Plan projects	12-9-59	178.6	2.5
6. Third Plan projects	21-2-61	59.5	2.5
Czechoslovakia			
Credit for import of machinery & equipment	November, 1959	23.1	2.5
Poland			
Credit for import of machinery & equipment	May, 1960	14.3	2.5
Yugoslavia			
Credit for import of machinery & equipment	January, 1960	19.1	3.0

The repayment arrangements between India and the socialist countries have the advantage of rupee payment. Payment of interest and principal is made mainly by deliveries of India's traditional export items. The agreements contain provisions either in a general form without specifying the commodity deliveries or in the form of specific assortments of commodities.

It is often pointed out that the over-valuation of the ruble introduces adverse terms for the countries receiving Soviet aid settled through commodity deliveries. But it

34. The rate of interest of 2.5 per cent applies not only to socialist aid to underdeveloped countries, but also to loans advanced by socialist countries to other members of the socialist bloc.

should be noted that even though prices are generally quoted at the official exchange rate for ruble, in actual practice the commodity supplies are negotiated at world prices in non-ruble currency, mainly sterling. This procedure corrects any over-valuation in the official rate of exchange for the ruble.[35]

Under the trade agreements between India and the socialist countries, the amounts received from the import of commodities from the socialist countries are calculated in rupees and kept in special accounts in Indian banks. These rupee receipts are then utilised by the socialist countries to purchase goods in India, thus promoting Indian exports. The payments arrangements, thus, ease our foreign exchange difficulties.

The relatively low interest rate charged by the socialist countries on their loans to underdeveloped countries and the generally favourable conditions regarding repayment did have an impact on the foreign aid policies of the capitalist countries. In the increasing competition between the two groups of countries for extending developmental aid to the underdeveloped countries it was inevitable that the capitalist countries provide aid on terms and conditions comparable to those offered by the socialist countries. The US Development Loan Fund and, recently the US AID, and also the International Development Association are now offering easy loans to the underdeveloped countries.

The operation of the DLF with regard to the rate of interest and other terms is now sufficiently flexible to take into account the needs of particular countries and their ability to service the debt and make the ultimate repayment. The two US AID loans announced at the end of March 1962 for a total amount of Rs. 57 crores, covering the import of critically needed commodities and finances for the Industrial Finance Corporation, carry with them no interest charges, but only a very low credit fee of three-fourth of one per cent. Further, the period of repayment is spread over a very long period of 40 years to minimise difficulties in debt

35. Malenbaum, n. 17, 43.

repayment. Similarly, the recent IDA loan for the tube-wells in U.P., a long-term loan with a maturity of 50 years, involves only a charge of three-fourth of one per cent to cover administrative expenses. The attempt has been to give IDA assistance 'on a basis strikingly different from the basis on which assistance has hitherto been available from international sources'.[36] With the creation of the IDA, resource flow from the capitalist countries has now started on terms comparable to those of socialist aid. In this sense the IDA has been the Western countries' 'response to the Soviet challenge in aiding backward countries on easy terms'.[37]

A significant feature of the aid policies of the socialist countries is the importance given to trade in a system of mutually beneficial aid. Along with the increase in financial and technical aid the socialist countries have stepped up their exports of machinery, equipment and other materials for complete industrial enterprises to the underdeveloped countries. The import of these materials by the recipient countries is facilitated by the commitments made by the socialist countries through bilateral trade agreements to accept, in return, export goods of the recipient countries.

The significance attached to trade as a form of aid in the foreign economic policies of the socialist countries is shown by the fact that in 1958 about 90 per cent of the total exports of the Soviet Union consisted of equipments and material for complete enterprise in the importing countries. Through the normal channels of trade the Soviet Union and other socialist countries help the underdeveloped countries in erecting industrial plants vital for their rapid growth.

The increased purchases of the socialist countries from the underdeveloped world not only expands the exports of the latter group of countries, but also introduces an element of stability in their exports. Unlike the capitalist markets which are continually affected by business fluctuations, the socialist countries offer a stable and continuously

36. N. 22, 6.
37. *The Statesman* (Delhi) 5 October 1959.

expanding market. The planned economic growth of the socialist countries enable the developing countries to neutralise the adverse effects of the world capitalist crises on them.

In the capitalist countries, generally, there exists a complete bifurcation between aid and trade policies. This has often resulted in the formulation of trade policies by the lending countries which, in effect, nullify the benefits conferred on the recipient countries through financial aid.

If the lending countries give us a fair price on the present volume of our exports or if they agree to increase their purchases from us in proportion to either the increase in their industrial production or foreign trade, we will receive, through the natural channel of trade, substantial foreign exchange resources for financing the much needed imports for our development plans.

The increasing foreign aid given by the socialist countries to the developing economies at favourable terms has compelled the industrially advanced countries of the West to revise their aid policies and, in many cases, to make the terms and conditions of their aid approximate to those of socialist aid.[38] This is amply illustrated by the experiences of India's Second Five Year Plan. At the commencement of the Second Five Year Plan, India was faced with the problem of mobilising external resources for the successful implementation of the proposed strategy of priority to heavy and key industries, in the public sector. The foreign aid policies of the industrially advanced capitalist countries were inimical to a pattern of development in India and other underdeveloped countries which gave emphasis to heavy industries and the expansion of the public sector. Negotiations for British and West German aid for iron and steel plants prolonged for nearly two years without any hope of positive results. But the announcement of Soviet

38. About aid from the Soviet Union, Charles Wolf, Jr., observed that such aid at lower rates will tend to lower the price which United States can charge the recipient countries for United States loans! (See Charles Wolf, Jr., *Foreign Aid: Theory and Practice in Southern Asia*, Princeton, 1960, 397).

offer for a Steel plant at very favourable terms[39] altered the situation and Western aid was immediately forthcoming. The aid agreement with the Soviet Union greatly enhanced India's bargaining strength in negotiating with British interests and the West German Krupp and Demag Consortium. H. V. R. Iyengar, then Governor of the Reserve Bank of India, commenting on the British aid for the Durgapur Steel Plant immediately following the Soviet offer of aid for Bhilai, observed that 'the interest Western Europe is displaying in India grows in proportion to the extension of India's business ties with Russia'.[40]

The impact of the foreign economic policies of the socialist countries on the capitalist countries is not limited to the field of foreign aid. In the sphere of foreign trade too, the impact is visible. *The Economist* (London) remarked: 'Were it not for the communist bloc, at least Asia and Africa would have more difficulty in maintaining trade relations with the West'.[41]

Up to the middle of the 1950's, the US held a virtual monopoly in the field of economic assistance to poor countries. The emergence of the Soviet Union and other socialist countries as an increasingly important competitor in the aid field, coupled with increasing pressure[42] from the developing countries for larger long-term aid, compelled the US government to evolve programmes for extending long-term developmental capital on a government-to-government basis. The result was the Development Loan Fund.

The changes in the foreign economic policies of the capitalist countries, however, do not indicate any fundamental change in the nature of monopoly capitalism. They highlight the attempts to minimise, and if possible avoid, the increasing contradictions within the world capitalist system

39. Commenting on the Bhilai Steel Plant, *The Eastern Economist* (New Delhi) 22 November 1957, observed that 'it would be difficult to conceive of a more favourable agreement'.
40. *Times of Indonesia*, 27 February 1959.
41. *The Economist* (London), 14 February 1959.
42. Pressure from the poor countries in the America's 'free world' sometimes take the form of 'polite blackmail' or even open ventilation of their grievances.

between the advanced countries and the underdeveloped countries, and face the increasing challenge from the world socialist system.

The foreign aid policies and programmes of the Soviet Union and other socialist countries have also not been without changes. The volume of foreign loans and credits and the terms and conditions of such aid are, no doubt, influenced to a certain extent by the need for offering effective competition to the advanced capitalist countries in the field of international aid. But there is another aspect of the foreign aid policy of socialist countries which bears the stamp of Western impact. Aid to the private sector industries in the developing countries has so far been the exclusive domain of Western capitalist aid, both private and public. The result of this has been the unfettered growth of foreign monopoly capital and the growth of a section of the domestic bourgeoisie supported by public and private funds from the advanced capitalist countries—a big bourgeoisie which is quite unashamed in extending direct and indirect support to foreign monopoly capitalism and imperialism. The national bourgeoisie, often wavering in its attitude to foreign monopoly capital, could not withstand this tendency unaided. The socialist countries, on the other hand, shied away from the private sector industries altogether and were willing to aid only projects in the public sector of the recipient countries. But in recent years, the experience of foreign aid programmes in the context of mixed economy in India and some of the developing countries has revealed the wisdom of extending socialist aid to the private sector of these countries as well. For instance, the Soviet Union has started negotiating techno-economic deals with the private sector industries in India.

A parallel development has been the recent preparedness on the part of the US to give aid to basic industries in the public sector in India. The proposal for erecting a public sector steel plant at Bokharo with US aid is to be viewed in the light of the increasing compulsions on the capitalist countries to readjust their foreign aid policies and programmes in the light of the special circumstances in the

developing countries of the mixed economy type. This 'cross-breeding' in international finance, that is, the movement of capital from the advanced private enterprise economies to the developing countries to strengthen their public sector industries, and the capital and skill flows from the socialist countries to develop the private sector industries in these developing countries, is a phenomenon which has significant portents for the future of international aid and the pattern of growth of the developing countries.

Chapter V

Mobilization of Foreign Capital Resources

THE quantum of external resources necessary for a recipient country at any given moment in time depends on a number of factors such as the already achieved level of economic development in the country, the targets for the future and the pattern of development programmes envisaged.

Generally, there are two methods for determining the foreign resource requirements of a development plan: (i) the 'investment gap' approach, and (ii) the balance of payments approach. The 'investment gap' approach consists of assessing the total capital resources which the recipient country can mobilise from within the country and then calculating the gap between the total planned outlay of the development programmes and the estimated domestic capital resources. The gap in resources will indicate the extent of foreign resources required.

The plan targets may include the increase in national income by a certain percentage, the creation of new employment for the additional labour force, or a change in the occupational distribution of the population in favour of the industrial sector. On the basis of statistics relating to a number of economic phenomena such as capital-coefficients and productivities of factors of production, etc., the total capital outlay of the plan is arrived at. Ways and means of financing the plan are then found out. The quantum of domestic savings, the possibilities of internal borrowing and, if necessary, deficit financing, are all looked into. The total domestic capital from all these sources may not be sufficient to meet the estimated outlay in the Plan. The impending gap,

therefore, is sought to be filled up by foreign borrowing.

The estimate of foreign capital requirements of underdeveloped countries in the Report prepared by the United Nations experts in 1951 on measures for the economic development of underdeveloped countries underlines the 'investment gap' approach.[1] The Report calculated that, on the basis of the 1949 prices, the underdeveloped countries would need a total investment of about 19 billion dollars per year in order to attain an annual increase in per capita income of 2 per cent. Taking domestic savings of the underdeveloped countries as 5 billion dollars and assuming that part of the gap would be met by increase in the ratio of domestic savings to national income during the period of growth, they estimated the foreign capital component of the development plans of the underdeveloped countries at 10 billion dollars or above 50 per cent of total investments. An FAO study in 1949 estimated that total investment needs of underdeveloped countries would be 9.4 billion dollars per year out of which 3.9 billion dollars or about 42 per cent of the total investment was taken as the foreign capital component.[2] Among the underdeveloped countries the share of foreign resources in the total investment varied between 27 per cent (in Latin America) and 53 per cent (in the Far East).

The balance of payments approach stems from one of the main functions of foreign capital, namely, the provision of foreign exchange resources of the development plan. Programmes of industrial expansion and general economic development involve the import of certain categories of foreign goods. In the initial stages of a programme of rapid economic development, the import content of the plan may be quite excessive. The volume of external resources required for the plan is arrived at by estimating the possible exports and imports (including invisibles) during the plan period and finding out from these figures the foreign exchange gap. This gap, according to the balance of payments

1. United Nations, *Measures for the Economic Development of Underdeveloped Countries* (New York, 1951) 73-9.

2. F.A.O., *Report on International Investment and Financing Facilities* (Paris, 1949) 9.

approach, fixes the foreign capital requirements of the country during the plan period.

Eugene Staley, in his calculations of foreign capital requirements of Asiatic countries followed the balance of payments approach.[3] Among recent estimates based largely on this approach, mention must be made of Paul Hoffman's estimates.[4] He estimates the total export earning and import requirements of the underdeveloped countries during the 1960's giving a trade deficit of 62 billion dollars during the decade. If we add another 8 billion dollars, being the deficit in invisibles for the period, we get an average annual deficit of 7 billion dollars per annum. The total foreign capital requirements of underdeveloped countries is thus 7 billion dollars, out of which the current annual net inflow amounts to 4 billion dollars.

The two approaches mentioned above are based on two aspects of the same problem—the problem of development finance, internal and external. The first approach emphasises the problem of filling the internal investment gap while the second approach highlights a related problem of external payments. Again, it is obvious that the calculations of foreign capital requirements is based on a number of assumptions regarding the structure of the economy, its parameters, the possible response of various economic factors to the efforts at economic growth, and the deliberate changes that are introduced by policy decisions. For instance, the calculations in the United Nations Report[5] was based on the target of a 2 per cent increase in per capita national income per annum. It was also based on the assumption of an annual transfer of 1 per cent of the total working population from agriculture to other sectors of the economy. The capital requirements for achieving the target of national income increase was calculated on the basis of an overall capital-output ratio of 8:1. Such an overall ratio

3. Eugene Staley, *World Economic Development* (International Labour Office, Montreal, 1944) 71-4.

4. Paul Hoffman, *One Hundred Countries, One and One Quarter Billion People*. See also, *International Trade, 1959* (Annual Report, G.A.T.T.).

5. United Nations, n. 1.

has very little usefulness in economic planning even for a single country. Its application for a group of countries at different levels of technical and economic development is, therefore, highly unwarranted.[6]

For Southeastern Europe, Rosenstein-Rodan made calculations on the basis of the target of absorbing the surplus of agricultural population of the area within a decade.[7]

Dr. V. K. R. V. Rao, who was 'tempted to make an addition' to this 'plethora of estimates', based his calculations of foreign capital requirements of underdeveloped countries on the experiences of India. Accepting the foreign capital component of the Third Five Year Plan as his basic data—which works out at about 3.2 dollars per capita—and taking into account the larger investment needs of other underdeveloped countries, Rao places the per capita foreign capital requirements at 3.5 dollars. Thus, he arrives at a figure of 7 billion dollars for the underdeveloped countries as a whole, and 4.5 billion dollars for the non-communist part of the underdeveloped world.[8]

It is obvious that such calculations based on wild assumptions, forgetting the divergent requirements of individual countries and the technical nature of the development plans of these countries, are bound to be devoid of much practical usefulness. The validity of all these calculations rest on the limited and restricted assumptions behind them. The acceptance of one set of figures in preference to another set depends mainly on the desirability and realistic nature of the assumptions.

The 'investment gap' and 'balance of payments' approaches

6. The 'unjustifiable assumption' of a high capital-output ratio of 8 : 1 was a point of criticism for V. V. Bhat. But he overlooked the inadequacy of the use of overall capital-output ratio when he himself used a ratio of 4 : 1 to arrive at a figure of 14 billion dollars as the capital requirements of the underdeveloped countries (out of which the foreign capital component was estimated at 7 billion dollars). — V. V. Bhat, 'External Capital and Economic Development', *Arthaniti*, II, 1 (November, 1958) 139-52.

7. Rosenstein-Rodan, 'Problems of Industrialization of Eastern and South-Eastern Europe', *Economic Journal* (June-September, 1943) 202-11.

8. V. K. R. V. Rao, *International Aid for Economic Development: Possibilities and Limitations* (Montague Burton Lecture for 1960, University of Leeds, 1960, mimeographed) 9.

though different in many respects, are not really contradictory. The difference between the two approaches is more apparent than real. This will be evident if we bring in all the relevant assumptions behind these crude formulations. There is no reason why these two approaches should not be integrated into a single method of calculating the external resource requirements of a country.

Broadly speaking, the extent to which a country has to rely on foreign resources is determined by the willingness on the part of the Government and the people to raise domestic resources. The level of domestic savings is not rigidly determined by the national and per capita income levels. The wide range of deviation between the actual and the potential economic surplus in many countries points to the distinct possibility of manipulating the domestic savings by governmental policy and reorganising the economic institutions. Thus, if domestic savings as a proportion of planned investment is pushed upwards, the dependence on foreign capital will be reduced to a certain extent. To the extent to which there is perfect substitutability between domestic and foreign capital, the 'investment gap' approach is operationally valid.

It should be remembered, however, that there is no perfect substitutability between domestic and foreign capital. Given the maximum limit of a country's foreign exchange earnings through exports and other current transactions, the amount of external capital which should be mobilised from abroad is given by the current account deficit which largely represent the physical requirements of machinery, equipments and raw materials for the particular pattern of economic development envisaged in the plan. In general, it may be stated, therefore, that the external resource requirements of the development plan is determined by the foreign exchange gap which itself is a reflection of the 'project pattern' of the plan. Domestic resources mobilised through channels such as taxation and domestic borrowings cannot be a substitute for foreign exchange resources. Given the project pattern of the plan, domestic capital can substitute foreign capital only to the extent to which the economy

can be induced or forced to build up higher exports and reduce the dependence on imports.

The estimation of foreign capital requirements based separately on the 'investment gap' and the 'balance of payments' approaches indicate that the two estimates are likely to be non-identical. This may well be so, for it is possible for a country at any moment in time either to add to or to have a draft on foreign exchange reserves. But this divergence in the end products of the two approaches is usually avoided, on a practical level, by re-framing and re-drafting the original development programmes. Thus, if the draft plan involves a divergence between the foreign exchange gap and the gap in domestic resources, necessary adjustments will have to be made either by changing the project pattern of the plan or by manoeuvre at the resources end, all 'designed to reconcile the two sets of calculations'.[9]

The formulation of an exhaustive and integrated approach to the calculation of foreign capital requirements of a country precludes any attempt to have rough and ready estimates. What is required is detailed study of the various sectors of the economy, their planned rate of growth and rate of investment, the import content of the various sectors and projects, their export performances and possibilities, the problems of domestic resource mobilisation with respect to taxation, public debt, surpluses from public enterprises, deficit financing, etc.

In determining the foreign capital requirements of the Second Five Year Plan, the Government of India and the Planning Commission followed the 'balance of payments' approach. According to the original estimates made at the beginning of the Second Plan, the possible foreign exchange gap during the Plan period was estimated to be Rs. 1,120 crores. This was arrived at by estimating the total exports and imports (including invisibles) during the Plan period and then finding out the deficit in the current account. The different items were estimated as follows:

9. A. K. Cairncross, *Factors in Economic Development* (George Allen and Unwin, London, 1962) 53.

	Rs. crores
1. Exports	2,965
2. Imports	4,340
3. Trade balance (1 — 2)	— 1,375
4. Invisibles (net) excluding official donations	255
5. Total current account (net)	— 1,120

According to the original estimate, this foreign exchange gap was to be bridged in the following manner:

	Rs. crores
1. Withdrawal from sterling balances	220
2. Expected inflow of private foreign capital	100[10]
3. External finance to be raised through the Government	800
4. Total foreign exchange needs	1,120

The experience of the first two years of Second Plan, however, belied all the expectations of the Planning Commission. During the first year itself our foreign exchange holdings exhibited signs of too much of a strain. While exports did not change materially from the estimates, there was significant increase on the import front, thus widening the gap in India's foreign exchange resources. A serious foreign exchange crisis developed and our foreign exchange reserves began to be exhausted at an alarming rate due to (1) increased imports of machinery, intermediate goods and other capital goods, (2) increased imports of luxury consumption goods resulting from the liberal import policy of the Government, (3) increased import of foodgrains necessitated by the slow rate of domestic grain production,[11] and (4) increased defence purchases.

10. It is surprising that the Planning Commission took this figure of Rs. 100 crores of private capital inflow while the trends in the inflow of private capital from abroad, as revealed in the Reserve Bank studies since 1948, did not warrant such an assumption. The annual net inflow of over Rs. 20 crores of private foreign capital during 1948-55, presumably the only basis for the Planning Commission's projections for the Second Plan, consisted entirely of reinvestments of profits and investments in kind; in terms of cash transfers there was actually an outflow of funds. Evidently, the Planning Commission accepted the figure of Rs. 20 crores per year or Rs. 100 crores for the five years of the Second Plan without realising the nature of this 'inflow' and its implications for foreign exchange earnings.

11. The estimate of food imports in the original balance of payments projections for the Second Plan was only 6 million tons. But the actual imports during the Plan period came to about 20 million tons.

The dimension of the foreign exhange crisis was such that the very foundations of the Second Five Year Plan were threatened.[12] Against Rs. 220 crores of sterling balances planned to be withdrawn during the entire period of the Plan, actual withdrawal during the first 10 months of the Plan itself came to about Rs. 223 crores. In other words, what we had planned to spend during the five years of the Plan was exhausted in less than a year of the commencement of the Plan. The sterling balances which stood at Rs. 746 crores on 31 March 1956, declined to Rs. 543 crores at the end of November 1956, to Rs. 523 crores at the end of January 1957, and to Rs. 242 crores at the end of May 1958. Actual withdrawal during the first two years of the Second Plan came to about Rs. 504 crores.

The fictitious nature of the expected private foreign capital inflow of Rs. 100 crores was only highlighted during the Second Plan period. The movement of private foreign capital in terms of foreign exchange earnings (that is, excluding re-investments of profits and investments in kind) showed an alarming disregard to the needs of the Indian economy during the foreign exchange crisis of the Second Plan. During that period, disinvestments were the largest, resulting in substantial net outflow of foreign exchange. Thus, the only way of meeting the foreign exchange gap, according to the Planning Commission and the Government, was to seek more external assistance from foreign governments and international agencies. On the basis of the new situation in the balance of payments, the Planning Commission had to prepare a new estimate of the foreign exchange gap and the foreign capital component of the Second Plan.

The heavy foreign exchange spending during the Second Plan period was, to a certain extent, due to lack of adequate planning in this sphere. To quote the Planning Commission's own words:

12. About India's foreign exchange crisis Geoffrey Tyson made the following remark: 'Responsible Indians would be greatly distressed if they were told that their rulers had recently given a display of financial "brinkmanship" which had made their friends in other countries gasp and hold their breath until the moment of danger was past' (see, Geoffrey Tyson, 'India's Breathing Space', *The Banker*).

> The adverse foreign exchange situation that developed during the Second Plan was due partly to underestimation of the direct foreign exchange requirements of the Plan and partly to failure to take into account sufficiently the growing import needs of a developing economy.[13]

The private sector, over which the Planning authorities have only insufficient control, exhibited undue dynamism resulting in a sharp increase in private investments in the early stages of the Second Plan. This had repercussions on the import front. Unplanned increase in imports was made possible by the liberal import policy of the Government—a policy of issuing import licences without assessing its consequences.

It is important to note, however, that the huge magnitude of the foreign exchange commitments during the Second Plan was, by and large, a reflection of the balance of payments deficits inherent in the pattern of economic development we have undertaken. It only highlights the fact that, in the early stages of our development, the import content

Table 36

FOREIGN EXCHANGE GAP IN THE SECOND AND THIRD PLANS
(Rs. crores)

Items	*Second Plan* (actuals)	*Third Plan* (estimates)
1. Exports	3,053	3,700
2. Imports*	5,360	6,350†
3. Trade balance (1—2)	—2,307	—2,650
4. Invisibles (net) (excluding official donations)	420	Nil
5. Capital transactions (net) (excluding receipts of official loans and private foreign capital)	—172	—550
Total	—2,059	—3,200

Source: *Third Five Year Plan,* 109.

* This includes imports under P.L. 480 and 655 assistance also.

† A break-up of this figure shows that Rs. 1,900 crores would be needed for the import of machinery and equipment for the Plan projects, Rs. 200 crores for imports of components, intermediate products, etc., for raising production of capital goods, and Rs. 3,650 crores for maintenance imports. The rest, that is, Rs. 600 crores represent imports under P.L. 480 and 655 assistance.

13. Government of India, Planning Commission, *Third Five Year Plan,* 109.

of the Plan is likely to be heavy, thus necessitating the mobilisation of substantial amounts of foreign capital. The estimated foreign exchange gap in the Third Plan also illustrates this point.

As can be noted from the above table, the Second Plan was, in certain respects, in a more favourable position compared to the current Third Plan. For instance, while the Second Plan had net receipts under invisibles amounting to Rs. 420 crores, the estimates for the Third Plan indicate that the receipts and payments in this item would probably cancel out leaving no net receipts from this source. Again, the Second Plan had relatively less burden of repayment and debt servicing. The Second Plan had also a sizeable foreign exchange reserve to fall back upon; but no such cushion is available for the Third Plan. The foreign exchange needs of the bigger Third Plan indicate that during the Plan period India will have to mobilise a much larger volume of external finance compared to that in the Second Plan. The estimates in the Third Plan places the figure at Rs. 3,200 crores for the five years, 1961-65.[14]

Table 37

(Rs. crores)

Items	*Second Plan* (actuals)	*Third Plan* (estimates)
1. External assistance (including P.L. 480 and 655 assistance)	1,406	3,200
2. I.M.F. drawings (net)	55	—
3. Use of foreign exchange reserves	598	nil
Total	2,059	3,200

Out of the Rs. 3,200 crores of external assistance indicated above, only Rs. 2,200 crores represent the budgetary receipts accruing to the exchequer for public sector investment. The rest of the amount of Rs. 1,000 crores includes about Rs. 450 crores to Rs. 500 crores of external assistance from international agencies going to the private sector,[15] and about

14. *Ibid.*, 112.

15. The Planning Commission includes private foreign capital inflows also in this figure; but on the basis of past experience, the foreign exchange contribution from this source may be taken to be negative.

Rs. 200 crores mainly in the form of P.L. 480 counterpart funds retained by the United States embassy for their disbursements.[16]

The foreign capital requirements of India's development programmes have been increasing over the Plan periods. During the First Plan period, external assistance as a percentage of total public sector outlay came to about 10 per cent. But during the Second Plan period, the share was nearly 24 per cent.[17] According to present indications, the share of external assistance in the total public sector outlays in the Third Plan will be about 29 per cent.

The mobilization of external finance from foreign governments is largely a function of diplomacy. The Second Plan period, particularly the days of the foreign exchange crisis, was marked by hectic moves by the Government of India to create favourable opinion among the official circles in the creditor countries towards the sanctioning of loans and grants for the Plan. The foreign tours of the Finance Minister were particularly significant in this respect.[18] To what extent the aid offered by the 'Aid India Club' involved political strings and compulsions, or to what extent the 'creation of favourable climate' abroad by the Government of India meant political compromises, is difficult to discern. But from the point of view of the pure mechanics of mobilizing external finance from foreign governments, the efforts of the Government during the Second Plan were successful beyond even optimistic expectations. Similar efforts being made during the Third Plan may also be expected to bear fruit, even though the aid from some of the advanced capitalist countries may be forthcoming only grudgingly.

16. Planning Commission, n. 13, 99.
17. *Ibid.*, 33.
18. A foreign tour by an Indian Industrial Delegation sponsored by the Federation of Indian Chambers of Commerce and Industry preceded (and at the last stage coincided with) the tour of the Finance Minister. The efforts of the representatives of big business was concentrated towards 'creating a favourable climate in a general way for his (the Finance Minister's) mission too, which by our activities we believe we did and helped in our own way to supplement his efforts'.—See, Federation of Indian Chambers of Commerce and Industry, *Report of the Indian Industrial Delegation* (New Delhi, 1957) 6.

To raise the enormous sums of foreign exchange for the Five Year Plans we will have to multiply our efforts in the domestic front too. India cannot go on piling up her external debt for ever. There should come a stage when our need for foreign resources would slowly taper off. This calls for hectic efforts in the home front to raise our productivity, particularly in the export sector.[19] But untill the time when the Indian economy can do away with foreign capital assistance, the problem of raising sizeable volumes of capital from abroad will continue to be one of our major preoccupations.

Will external resources of such large magnitudes be forthcoming during the Third Plan and the succeeding ones? Is it realistic to assume that foreign capital will be available from advanced countries at an increasing rate for an indefinite time span to insure the economic development of India and other underdeveloped countries? To give even tentative answers to these questions, we should analyse the main factors affecting the mobilisation of international capital in general.

The magnitude of external resources which a country can mobilise depends upon both the demand and supply factors, that is, forces affecting the international flow of capital both in the lending countries and in the borrowing country. The determinants on the demand side are mainly the capacity to attract foreign capital and the capacity to absorb it. The 'capacity to attract' refers to the ability of a country to induce external resources from abroad in a magnitude necessary for the development of the economy, particularly the incentive conditions provided by the capital-importing country to encourage the inflow of capital from abroad. The factors which are important on the supply side are the availability of surplus capital in the lending countries and

19. The clear proof of India's capacity to accelerate her domestic capital formation and general rate of growth may be demanded by international institutions and donor countries before they advance financial assistance to India any more. In this sense, there is an indirect relationship between India's ability to raise domestic resources and the confidence and willingness of donor countries and institutional investors to invest their resources in India.

the willingness of the investors in the lending country to divert the surplus capital to the particular recipient country as the best alternative investment.

Generally, capital moves from a country where it is relatively abundant to a country where it is scarce. The history of international capital movements in the past, for instance the capital exports of Great Britain, France, Holland and Belgium, has shown that capital flowed from 'countries possessing a surplus to countries where requirements exceed their own supply'.[20] The availability of surplus capital in the advanced countries is the major prerequisite of capital export to underdeveloped countries. 'All foreign investments are the result of the flow of capital from areas where it is comparatively plentiful to those where it is relatively scarce'.[21]

It is important to remember that when we speak of the availability of surplus capital in the investing countries, we do not assume the existence of a fixed reservoir where surplus capital is stored up to be exported to the borrowing countries. In the case of private foreign capital, investment decisions being done by companies and corporations, the availability of foreign capital refers primarily to the investment decisions of these companies and corporations.

The international capital resources mobilised through bilateral and multilateral channels are also related to the investment decisions of the governments or international institutions, as the case may be. The availability of international capital through these channels is essentially determined by the will of these institutions to raise resources in order to help needy countries in their efforts for speedy economic development. In other words, the availability of international capital from bilateral and multilateral sources refers not only to the volume of resources already at their

20. Paul Einzig, *Bank for International Settlements* (Macmillan, London, 1930) 25.
21. F. Cyril James, 'Benefits and Danger of Foreign Investments', *The Annals of the American Academy of Political and Social Sciences*, 150 (July, 1930) 76.

command, but also to their deliberate decisions to replenish their resources for investment in underdeveloped countries.

In the case of international private capital, the sources of supply are limited to a relatively small number of large companies in the investing countries. An analysis of data relating to companies and corporations in the United States show that of the 2,000 companies which are engaged in foreign investments, 442 companies account for about 93 per cent of all foreign investments by corporations.[22] This shows that only the largest companies in the United States are interested in or capable of undertaking investments abroad.

Another important fact to remember is that out of the total capital assets of United States companies, investments abroad account for only a very insignificant share of 2.2 per cent. If we exclude American investments in Canada the percentage figure would come down to 1.5 per cent. This apparent neglect of foreign investment by United States companies is characteristic not only of small companies but also of the large corporations. Only about 5.9 per cent of the total capital assets of the 442 largest corporations in the United States is invested abroad (excluding Canada).[23]

The fact that only a very minute share of the total capital assets of companies in the investing countries is at present diverted to foreign investment projects might suggest that there is substantial scope for mobilising larger volumes of foreign capital if these companies can be made more conscious of the need for investments abroad. However, we cannot be over-confident about any sudden increase in investments by the companies in the investing countries.

The various economic considerations which induce the foreign private investors to invest their capital abroad can be classified into three main groups: (i) the profit incentive, (ii) the export incentive, and (iii) the import incentive. In the first case, the investment decision of the investors is based on an assessment of the possible profit rate in

22. E. R. Barlow and Ira T. Wender, *Foreign Investment and Taxation* (Prentice-Hall, Englewood Cliffs, 1955) 218.
23. *Ibid.*, 218.

the country under consideration. If the profit rate in the foreign country is larger than alternative investments in their home country by a margin sufficient to offset their calculations of risk and other uncertain factors, the decision would be in favour of investing thêir finance abroad.

Export incentive and import incentive refer to the considerations of a foreign investor or company of capturing a foreign market for their home produced goods or acquiring control over the imports of certain products for the continued operation or expansion of their business. For example, a company in (creditor) country A, already engaged in exports to (borrowing) country B, may consider the possibility of starting a factory in country B for the production of the same commodity which is at present being exported to country B. The starting of a factory in country B would facilitate their business operations further as the presently exported product can be made available to country B's market directly from the foreign factory in country B. Investment abroad may also be a method to escape from trade restrictions such as import duties, quotas and licences. Moreover, the supply of the goods from the factory in country B can be done with local brands and by humouring the national sentiments of the consumers in country B's domestic market. Similarly, an export firm in country A which does not have any control over the market in country B at present, may consider the starting of a factory in country B as the best way to capture the market of that country. In all these cases, the expansion of exports is the driving force behind the investment of capital in country B.[24]

The growth of oil companies in India offers a concrete example of foreign investment based essentially on export incentive. Two American and one British companies have set up oil refineries in India with the primary objective of retaining the Indian market. These companies had already

24. Referring to us investments abroad, Dunning observes that one of the principal objects of the United States was 'to secure outlets for the export of her manufacturing products'.—John H. Dunning, *American Investment in British Manufacturing Industry* (George Allen & Unwin, London, 1958) 286.

in their control a considerable distributing business in India. With increasing competition between them, these companies probably considered it necessary to start refining of crude oil in India in order to retain their hold on the Indian market and to extend their business as far as possible. India offers an ever-increasing internal market for oil, and this gives a strong incentive for oil companies to extend their business in India.[25]

The necessity for United States private concerns to invest in India in order to maintain and develop existing market and to jump over India's protective tariffs and import restrictions was stressed by George Rosen in the following words: 'The Indian government's policy is to protect domestic producers.....This means that direct investment will probably be necessary to protect the existing market, and potentially larger market.'[26] The capture of new markets (or the protection of existing markets) has always been one of the prime motivations of American private foreign capital and international private capital in general. In the words of Randell, it is a 'force which will drive American business beyond the oceans.'[27]

Import incentive may also influence the investment of capital from foreign countries. A company engaged in the production of a particular commodity in country A may consider the setting up of a factory in country B in order to facilitate the raw material or intermediate goods imports needed for the industry in country A. This was largely true of a number of investment projects of British investors in the early period. In the case of United States direct foreign investments, '...the prime consideration is and always has been the availability of a natural resource, a consideration

25. Other examples of foreign companies in India for which the export incentive has been a determining factor in investment decisions are the Imperial Tobacco, Hindustan Lever, Western India Match Company and Natural Carbon.

26. George Rosen, 'Problems of Private Investment in India by American Firms', *American Trade with Asia and the Far East*, Ed. Robert J. Barr (The Marquette University Press, Milwankee, Wisconsin, 1959) 132.

27. Clarence B. Randell, *The Communist Challenge to American Business* (Little, Brown and Co., Boston, 1959) 47.

which seems likely to increase greatly in importance for the United States'.[28] Aluminium companies in the United States, realising that sufficient bauxite was not available within the country, went abroad to Central America to ensure the supply of bauxite and 'to serve the great future of aluminium'[29] industry in the United States.

The fact that a substantial portion of United States private investments abroad have gone into petroleum and mining, only strengthens the contention that one of the main motives of United States foreign investments is to acquire command over the supply of raw materials and other products necessary to sustain the domestic industries in the United States. In 1953 about one-sixth of the total raw materials imports into the United States was supplied by American subsidiary companies operating abroad.[30]

For private foreign investments, the major incentive for investment abroad is the rate of interest or profit which they can earn. Companies invest abroad on the basis of their forecasts of profitability. This test of profitability does not demand a substantially large profit in the borrowing countries in comparison to the investors' mother country.[31] Even if the differential between the rates of profit or interest in the investing and borrowing countries is not significant, say 5 per cent in the investing country and 6 per cent in the borrowing country, the foreign private investors generally prefer to venture their capital abroad, provided there is equal security for their investments. The reason for the low rate of capital inflow from the advanced countries to the underdeveloped countries is often due to the foreign investors' apprehensions about future security of their capital and not the low rate of profits in the recipient countries as often alleged by many economists. As a matter of fact, rates of interest and profit are 'frequently higher in new countries...than they are in the older and wealthier countries'[32]

28. N. S. Buchanan and Howard S. Ellis, *Approaches to Economic Development* (The Twentieth Century Fund, New York, 1956) 346.
29. Randell, n. 27, 34.
30. Dunning, n. 24, 286.
31. Barlow and Wender, n. 22, 143-4.
32. James, n. 21, 76-7.

As far back as 1870-80, an investor in foreign government securities could get an average return of 4.5 to 5.5 per cent. This was about 1 to 1.5 per cent higher than the return on Consols.[33] The average yields on foreign government securities were quoted at 5.39 per cent and 4.9 per cent during 1900-4 and 1905-9 respectively. The yields on Consols during the same periods were only 2.7 per cent and 2.88 per cent respectively. An estimate by Sir George Paish showed that the yield quoted for foreign securities in 1907 was 5.2 per cent while Consols provided an yield of only 3 per cent. Even the Indian government loans which were the lowest in yield among foreign securities fetched a yield of 3.21 per cent, that is, higher than the yield on Consols.[34]

A study of the earnings of United States investment in their home country, in the developed countries and in the underdeveloped countries will reveal the fact that in most of the fields of business activity the yields of United States investments are greater abroad than in the United States. The overall ratio of earnings to book value of private US direct foreign investments (in all fields) in the underdeveloped countries and developed countries were 17.8 per cent and 14.2 per cent respectively in 1948, while the earnings of US investments within the United States was only 13.8 per cent. Of course, the position was different in different fields. For example, in 1948, the earnings of US investments in the United States in distribution, though less than in the underdeveloped countries, was definitely higher than the yield in developed foreign countries. Throughout the period 1945-8 the yield of investment in public utilities in the United States was higher than the yield in foreign countries, developed as well as underdeveloped. The average rate of earnings in public utilities in the United States during 1945-8 was 5.5 per cent compared to 4.2 per cent and 3.3 per cent in the developed and underdeveloped countries respectively. However, in most of the sectors such

33. A. K. Cairncross, 'Did Foreign Investment Pay?' *The Review of Economic Studies* (October, 1935) 73-4.

34. Royal Institute of International Affairs, *The Problem of International Investment* (Oxford University Press, London, 1937) 119.

as manufacturing, mining and petroleum, underdeveloped countries offered a higher yield for the United States investments. For instance, in the manufacturing sector, the average rate of earning of American direct investments in 1945-8 was 15.8 per cent in underdeveloped countries compared to 14.3 per cent in the United States. Petroleum profits in the underdeveloped countries have been the most striking with 26.8 per cent during 1945-8. This is to be compared with the rate of earnings in the United States in petroleum of 14.6 per cent in the same period.[35]

During 1950-55, the average rate of earnings of United States direct foreign investments was 14 per cent in manufacturing and 21.1 per cent in petroleum, while it was only 4.5 per cent in public utilities.[36] Thus, it is clear that not only are profit rates generally higher in the underdeveloped countries compared to the advanced countries, but the profit differentials are significant in petroleum and manufacturing sectors while public utilities are conspicuous by their uniformly low yields.

The relatively low level of earnings in public utilities gives us a clue to the hesitation of foreign private investors to enter into public utilities without governmental guarantee even in the hey-day of international private capital. The development of railways in India during the British period also testifies to this fact. Compared to manufacturing and extracting industries, public utilities are less attractive also because they have a long maturity.

The possibility for high profit margins exist in India and other underdeveloped countries. But the rate of foreign capital inflow still remains very low. This is due to the operation of factors other than profit rate. For example, the foreign investors' apprehensions about the possible risks puts a restraint on capital movements:

> When a company is short of capital and must decide whether to devote its capital and management talents to

35. H. J. Dernburg, 'Prospects for Long-Term Foreign Investment', *Harvard Business Review* (July, 1950) 41-51.

36. Source: United States, Department of Commerce, *Survey of Current Business* (January, 1954); (August, 1956).

> domestic or foreign investment, invariably domestic investment with the known risks will assume precedence over foreign investment with the unknown or unfamiliar risks.[37]

Particularly if the starting of an operation requires a huge initial capital outlay the foreign investors tend to exhibit signs of shyness. Walter S. Salant admits that the potential marginal product of United States foreign investments is probably higher than that of investments in the United States even if the external economies in the recipient countries are ignored. He further observes that in spite of this economic basis for increased capital export to underdeveloped countries, the rate of capital export remains at a low level.[38] Obviously, there must be other factors which tend to outweigh the incentives of high profit rates in the underdeveloped countries.

During the hey-day of British international investments, that is, during half a century prior to World War I, about two-thirds of British capital went into regions of new settlement, such as United States, Canada, Australia and Argentina.[39] The most important stimulant, and in many cases the source of supply, of these capital outflows was the large-scale immigration involving about 60 million people from Britain and Continental Europe.[40] Again, international private investments have a tendency to concentrate in the advanced countries and not in the underdeveloped countries of Asia and Africa.[41] As Buchanan and Ellis have pointed out,

37. Barlow and Wender, n. 22, 222.

38. Walter S. Salant, 'The Domestic Effects of Capital Export under the Point Four Program', *American Economic Review*, 40 (1950) May Number, Papers and Proceedings, 502.

39. R. Nurkse, 'International Investment in the Light of Nineteenth Century Experience', *Economic Journal* (December, 1954) 744-58.

40. A. K. Cairncross, *Home and Foreign Investment, 1870-1910* (Cambridge, 1953) 209.

41. American private (direct) investments in Asian and African countries at the end of 1945 accounted for only 10 per cent of total United States private investments in the world. Even though the percentage share increased to 15 per cent in 1950, the increase was concentrated in a few petroleum producing countries.

> ...because private capital naturally seeks the optimum combination of safety and yields, it has a perverse tendency, from the viewpoint of countries standing low in the scale of economic advancement, to move first into the stronger regions and the more solid and lucrative industries.[42]

And as a study by the United Nations observes:

> A considerable share of the capital has been absorbed by countries which have achieved a substantial degree of industrial development and are at the same time richly endowed with natural resources....It appears that private foreign capital tends to be attracted to such resources rather than to abundant manpower.[43]

This has been true particularly of United States private foreign investments. A study of the capital exports of the United States will show that private investors always had a preference for advanced countries such as Canada and Western European countries and countries under its immediate influence such as the Latin American countries. This pattern has been visible from the early years in the history of American private investments abroad. In 1923 about 30 per cent of the total American foreign investments were in Canada and Newfoundland. Another big chunk of United States investments abroad to the order of 46 per cent was in Latin America. Europe accounted for 16 per cent. But the percentage share of Asia and Oceania was only 8 per cent. The total value of United States investments abroad in the various regions of the world along with the percentage share of these regions is given in Table 38.

The American investor's preference for Canada, Latin America and Europe has been an abiding spirit all through the history of American foreign investments. Out of the total capital outflow from the United States during 1946-51 amounting to 3,682 million dollars, Latin America accounted for 1,629 million dollars or 44.2 per cent of the total outflow. Canada and Western Europe accounted for 21.2 per

42. Buchanan and Ellis, n. 28, 350.
43. United Nations, *International Flow of Private Capital, 1946-52* (New York, 1954) 6-7.

Table 38

AMERICAN INVESTMENTS ABROAD AT THE END OF 1923

Regions	*U.S. investments (million dollars)*	*Percentage*
Canada and Newfoundland	2,450	30
Europe	1,300	16
Latin America	3,760	46
Asia and Oceania	595	8
Total	8,105	100

Source: Robert W. Dunn, *American Foreign Investments* (B. W. Huebsch and the Viking Press, New York, 1926) 183.

cent and 8 per cent of the capital outflow respectively. Of the total United States investments abroad outstanding at the end of 1951, about 39.4 per cent was in Latin American countries, 31 per cent in Canada and 14.4 per cent in Western Europe.[44] United States direct foreign investments during 1952-7 is presented in the following table:

Table 39

UNITED STATES DIRECT FOREIGN INVESTMENTS OUTSTANDING, 1952 AND 1957

(Million dollars)

Area	*1952*		*1957*	
	Amount	*Percentage*	*Amount*	*Percentage*
Canada	4,593	31.0	8,332	33.0
Other Western Hemisphere*	5,916	39.9	9,144	36.2
Western Europe	2,146	14.5	3,993	15.8
Rest of the world	2,163	14.6	3,783	15.0
Total	14,819	100.0	25,252	100.0

Source: United Nations, *The international flow of private capital, 1956-58* (New York, 1959) 25.

* This includes Latin American countries and Western European dependencies.

While the percentage share of Canada and Western Europe increased by 2 per cent and 1.3 per cent respectively, there was a shortfall in the percentage share of the under-

44. *Ibid.*, 12.

developed countries represented in the above table under the categories 'Other Western Hemisphere' and 'Rest of the world'. The advanced countries such as Canada and those in Western Europe and the countries under the influence of the United States in Latin America, together account for about 85 per cent of the total outstanding direct foreign investments of the United States.

The tendency of foreign private capital to flow into advanced countries and countries under the political influence of the investing country has to be explained by factors other than the rate of profit and other conventional considerations. Political considerations apart, the most important economic compulsions for the concentration of American private investments in these countries are the need for exploiting wide domestic markets, the need for minimising the hazards of pioneering an enterprise and attain the maximum degree of investment security.

In the advanced capitalist countries the question is often posed: how to 'reopen the floodgates' of private international investment?[45] It is argued that it will be possible to re-establish the 'automatic' movement of private capital (in response to the best areas of profitable investment) which has been characteristic of the international capital movements of the 19th and early 20th centuries, if only the existing deterrents to private capital are removed. How far is this optimism based on reality? British capital exports before 1914 amounted to about 7 per cent of its national income, a performance which, if repeated today by the United States, will yield about 30 billion dollars per year for international investment, against the present annual outflow of American capital of 10 million dollars including private and public capital. Is it realistic to expect a similar magnitude of international private capital today?

The era of large-scale movements of international private capital came to a close in the late 1920's when the economies of the advanced capitalist countries were severely

45. European League for Economic Cooperation, *Common Protection for Private International Capital* (Publication No. 25, February, 1958) 5.

hit by the Great Depression. 'The political and social conditions of the unhampered flow of capital and enterprise no longer exist in most countries....'[46] Again, colonial investments, made possible through the political and economic subjugation of the colonies by the investing mother countries have no place in the changed conditions of today.

In the postwar period up to 1955, the average rate of private capital outflow was about 1.5 billion dollars per year and in the 1950's it exceeded 2 billion dollars annually. In real terms this was only about half the annual outflow during the 1920's.[47] Since 1955, no doubt, the international flow of private capital has witnessed a slight recovery. During the four years 1955-8 the total outflow of long-term capital from the major creditor countries was at the average rate of 4 billion dollars per year. The peak was attained in 1957 when private capital outflow amounted to 5.7 billion dollars.[48]

It is difficult, however, to assume that the recovery in international capital movement since 1955 will be converted into a lasting trend and attain for private capital the predominant position which was characteristic of international capital movements before the 1920's. But even if we can confidently anticipate the continuation of the present trends, the total magnitude of private capital resources, particularly in real terms, would still continue to be insignificant in relation to the increasing needs of the recipient countries for foreign resources. Therefore, it would be useful to ask ourselves the same old question as to what prompted the restrictive flow of international private capital after the World War I and the stagnation in the rate of flow. Various explanations have been given by many economists for this phenomenon.

It is a generally accepted fact that the general disinte-

46. Raymond F. Mikesell, *Promoting United States Investment Abroad* (National Planning Association, Washington, D.C., 1957) 36.
47. Gunnar Myrdal, *An International Economy* (Routledge & Kegan Paul, London, 1956) 105.
48. United Nations, *The International Flow of Private Capital, 1956-58* (New York, 1959) 9.

gration of the international economic system immediately following the world wars had an adverse effect on international private capital movements. Political risks arising out of the instability of governments in the underdeveloped countries has weighed in the foreign private investors' investment decisions. As the imbalance in the foreign payments position of recipient countries after the war have been sought to be corrected through exchange controls, the foreign investors' fears about future transfers of profits have increased.

The decline in international private capital was largely due to the virtual collapse of the international market in private portfolio or creditor capital. During the 19th century portfolio (creditor) investments[49] constituted a significant portion of the total international private capital. The major portion of British capital outflow was in the form of portfolio investments. In the case of the United States, about 59 per cent of the total increase in long-term investments abroad during 1914-29 was portfolio.[50] But in 1930 the share of portfolio investments was reduced to 46 per cent. On the other hand, direct investments showed a continuous increase, accounting for 59 per cent in 1946 and 73 per cent in 1953.[51]

Portfolio capital had its own peculiar considerations of risks and uncertainty. The industrial firms or institutions which floated loans in the world money markets could induce the foreign investors by arranging guarantees against default of the obligations. However, some of the bonds were defaulted on.[52] Even though the actual defaults were not

49. The term 'portfolio' investments is retained here because it happens to be the term widely used in discussions on international capital movements. But, as has been already noted in an earlier chapter, it really refers to 'creditor' capital. Portfolio capital includes not only creditor capital, but also that part of equity capital which does not involve actual control over the business.

50. Lewis Cleona, *America's Stake in International Investments* (The Brookings Institution, Washington, D.C., 1938) 595.

51. United States, Department of Commerce, *Survey of Current Business* (May, 1954) 10.

52. The foreign investors' fear of default on loans was definitely out of proportion to the actual defaults. Facts show that during 1920-31, about

too serious to cause panic in the international money markets, their psychological impact was sufficiently serious to affect adversely the rate of international capital flow.

It is true that in recent years portfolio investments have regained some momentum. In the United States, for instance, new issues of foreign securities amounted to 600 million dollars in 1957 and 956 million dollars in 1958, compared to an average of about 300 million dollars annually during 1950-55.[53] The rate of new issues since 1955 compares favourably with that in the 1920's with the peak of over one billion dollars for the years 1927 and 1928. The recovery is striking in comparison to the decade after the Great Depression of 1930 when the new foreign issues in the United States never exceeded 100 million dollars in any year.[54] But in spite of this recovery, the total value of United States portfolio investments outstanding at the end of 1958 was only about 6.5 billion dollars, lower than that at the end of 1930 by one billion dollars.[55] The shortage is really much larger if we take into account the decrease in the purchasing power of the dollar by about half during 1930-58.

The recovery in portfolio investments in recent years seems to be of little consequence to the underdeveloped countries. The predominant share of the new issues of foreign securities in the United States was accounted for by Canada, Western Europe and the International Bank for Reconstruction and Development. Canadian bonds and the bonds of the IBRD together account for over 80 per cent of the new issues.[56] Among the underdeveloped countries, only Latin American countries are in the picture; but they

40 per cent of the bonds issued by the underdeveloped countries were serviced without any default. Another 45 per cent of the bonds, though defaulted, have been eventually refunded and serviced. In 1950 only 15 per cent of the bonds were in actual default.—United States, *Report to the President on Foreign Economic Policies* (Gordon Gray Report), Washington, November, 1950, 62.

53. United Nations, *The International Flow of Private Capital, 1956-58* (New York, 1959) 51.

54. *Ibid.*, 50.

55. *Ibid.*, 51.

56. *Ibid.*, 53.

represent 'a steadily decreasing share of US holdings of foreign dollar bonds.'[57] The decline in the United States holdings of outstanding Latin American issues occurred mainly through amortization and repatriation, thus resulting in a decline from 470 million dollars at the end of 1945 to 320 million dollars at the end of 1951.[58] Since the end of the World War II, underdeveloped countries have accounted for only a small part of the portfolio capital floated on the main capital markets of the world.

The pattern of recovery in international private capital movements in recent years, thus, does not brighten up the prospects of enlarged foreign capital resources for the underdeveloped countries to any significant extent. Low-income countries, particularly countries which do not possess industrially important natural resources and wide domestic markets continue to get little private capital, in spite of the recent recovery in international private capital movements. In the case of the United States, its direct private investments in the primary exporting countries which was at an average level of one billion dollars in 1956-7[59], declined to less than 0.3 billion dollars in 1960.[60] Again, in the case of the United Kingdom, net private long-term investments showed a decline during 1958-60 from £184 million in 1958 to £154 million in 1959 and to £136 million in 1960. Private capital outflow from France to primary exporting countries also showed a decline. Western Europe which has recently emerged as a substantial exporter of private capital is still concentrating on capital exports among themselves rather than to underdeveloped countries, because of the Western European absorption of capital resulting from the investment boom in that area.

Of course, the international flow of private capital can be influenced, to a certain extent, by the provision of spe-

57. *Ibid.*, 52.
58. Willard L. Thorp, *Trade, Aid, or What?* (The John Hopkins Press, 1954) 193.
59. This was, of course, in some way exceptional because 1956-7 was a period of every high petroleum investments in Venezuela.
60. United Nations, *World Economic Survey, 1960* (New York, 1961) 181.

cial incentives. A term which often finds its way into the economic literature dealing with this subject is the 'investment climate' for foreign enterprises. Even though this term is used with different denotations by different writers, we can try to concretise it by bringing into its reference the economic, social, political and legal factors which determine the opportunities for private capital. Investment climate includes two aspects: (i) 'environment factors', which relate to the general economic, social and political framework of the country, and (ii) 'specific factors' which relate to specific policies and measures affecting foreign investments as such.

The internal economic and social structure of the recipient country may have a 'significance for the foreign investor'.[61] But most of these environment aspects are deeply embedded in the national outlook of the country so that it is highly unrealistic to expect any significant change in these conditions for providing incentives to foreign capital. But alterations in specific policies and measures affecting foreign capital are often possible within the broad framework of national economic policy.[62]

Three groups of factors which determine the climate for private foreign investments have been listed in a study in the *Economic Bulletin for Asia and the Far East.*[63] They are (i) laws and regulations applying directly, (ii) general background of economic and political conditions in the country, and (iii) factors such as manpower and material resources, market conditions and prospects, transport facilities, stability or instability of exchange rates, expectations regarding political and economic changes. The Indo-American Conference held at New Delhi in the second and third weeks of December 1949 discussed the possibilities of large-scale investment of United States capital in India.

61. Willy Feuerlein, and Elizabeth Hannan, *Dollars in Latin America* (Council on Foreign Relations, New York, 1941) 10.

62. For a detailed treatment of the policies and measures affecting foreign investments in India, refer to Chapter VIII.

63. 'Laws and Regulations Affecting Foreign Investment in Asia and the Far East', *Economic Bulletin for Asia and the Far East,* VIII, 1 (May, 1957) 1.

The American delegation pointed out the following factors as the elements in American investors' fears regarding investments in India:[64] (1) high level of taxation, (2) high cost of living, (3) regulations regarding limitations of dividends, (4) existence of sales and excise taxes, (5) contemplated legislation of the control of industry and state participation and nationalisation of industry, (6) wage fixation and profit-sharing schemes, (7) labour adjudication awards, and (8) import and export controls.

Among the deterrents to international private capital flow, the taxation level in the recipient country is often referred to by foreign investors as a serious deterrent.[65] But it is on record that during the last decade the Government of India has announced a number of tax concessions to foreign enterprises.[66] Judged from trends in foreign private capital inflow into India so far, however, the incentive effect of tax concessions on the volume of capital inflow is open to doubt. We are inclined to agree with Barlow and Wender that tax concessions have little or no relation to the investment decisions of foreign investors.[67]

Cost of living has, no doubt, been on the increase in India in recent years. But the fact remains that the cost of living in India is definitely lower than in the investing countries. The grievance of foreign executives in India seems to be mainly 'in respect of that range of goods such as alcoholic drinks and imported foods—which foreign executives choose to consider a virtual necessity'.[68] However, it will be an

64. *Commerce* (Bombay) 7 January 1950, 8.

65. Presiding over a meeting of the Associated Chambers of Commerce of India at Calcutta on 5 December 1958, Mr. J. D. K. Brown characterised taxes in India, namely, tax on share issues, on capitalisation of profits, dividend tax, etc., as factors influencing a foreign company's decision about investment in India.—*The Statesman* (New Delhi) 6 December 1958.

A leading American industrialist, Mr. George A. Rubissow, stated in New Delhi on 17 April 1959, at a press conference, that in the matter of encouraging foreign capital into India the main defects in the Indian system are 'the high rate of taxation and uncertainty regarding the re-exports of profits'.—*The Times of India* (New Delhi) 18 April 1959.

66. For a detailed discussion see Chapter VIII.

67. Barlow and Wender, n. 22, 217.

68. *The Eastern Economist* (New Delhi) 1 November 1957, Blue supplement, iv.

exaggeration to assert that the general cost of living in India is an impediment to foreign capital in the sense that it adversely influences the investment decisions of foreign investors and the readiness of foreign managerial and executive personnel to come to India.

Even if positive measures are undertaken to promote private capital movements and comprehensive safeguards are made to avoid any possible deterrent to such movements, it cannot be assumed that international capital will flow into the underdeveloped countries to any significant extent. Such an assumption reflects misunderstanding about the motivations of private capital. Indeed, if past experience is any guide, private capital is likely to flow more and more into countries which are already advanced rather than to backward countries.

The reluctance of foreign private investors to venture their capital in India and other underdeveloped countries, in spite of the possibility of higher returns, is to be explained not only in terms of the various factors to their distaste, but also in terms of the nature of private foreign capital to seek maximum profits over and above the normal profits available in the underdeveloped countries.

> There can be no doubt that, relative to the earnings in the United States, foreign private capital brings high returns in the underdeveloped areas.... But high rates of return do not necessarily mean excessive profits as shown by the reluctance of private capital to enter the international investment field.[69]

The international movement of private capital is governed by the 'law of maximum profits'. It is the 'profit motive on existing investments' that is important for foreign private investors than the 'investment motive on new ventures'.

The tendency of private foreign capital to desist from any substantial inflow into underdeveloped countries, in spite of the higher yields offered by most of the sectors, means that undue reliance cannot be placed on private foreign capital in the economic development of these countries.

69. Buchanan, and Ellis, n. 28, 349.

This is of particular concern to India. In spite of every effort on the part of the Government of India to encourage the inflow of private foreign capital through a liberal policy towards it, India has not succeeded in attracting private foreign capital to any significant extent. Stephen Garvin, in a report presented to the Federation of British Industries observed that, 'India is prepared to welcome foreign investment on terms which are not unreasonable, have been conscientiously adhered to, and compare well with those enforced by other underdeveloped countries'.[70] And it is on record that India never defaulted any of her foreign obligations in the past. India is among the few borrowing countries which have a clean record of scrupulous adherence to foreign obligations. Despite this knowledge among the foreign investors, the inflow of private foreign capital into India has not been very significant. It seems that 'For a variety of reasons, much of the spirit has gone out of private international investment'.[71]

If the history of international capital movements has anything to teach us, it is the fact that international private capital (whatever its role in the economic development of borrowing countries might have been in the past) is inadequate to meet the capital requirements of underdeveloped countries today.

The magnitude of financial assistance, both by way of loans and grants, received from foreign governments on a bilateral basis, on the other hand, has been quite substantial. Given the dynamics of economic competition between the advanced capitalist and socialist countries, we can safely conclude that from the point of view of the magnitude of resources available, bilateral arrangements have to play a far greater role than multilateral arrangements.

The external resources which India has been in a position to mobilize during the First and Second Five Year Plan periods reflect the truth of this contention. The inflow of private foreign capital, including re-investments of profits

70. Quoted in National Council of Applied Economic Research, *Taxation and Foreign Investment* (Asia, Bombay, 1957) 10.
71. Buchanan, and Ellis, n. 28, 343.

and investments in kind, amounted to less than Rs. 100 crores during the First Plan period. On the other hand, the total financial assistance received from foreign governments and international agencies for the First Plan was about Rs. 298 crores out of which the loans taken from the World Bank accounted for Rs. 12 crores. The major share was from the United States which amounted to about Rs. 230 crores.

The Second Five Year Plan was formulated on the basis of a greater dependence on economic assistance from international agencies and foreign governments. It was originally estimated that the inflow of private foreign capital would remain at the figure of Rs. 100 crores during the Plan period and that a substantial sum of Rs. 800 crores would have to be mobilised from foreign public sources. In actual practice, however, our dependence on foreign government for the necessary foreign finance increased during the course of the Second Plan, the total authorisation during the Second Plan totalling about Rs. 2,569 crores out of which the estimated utilisation was Rs. 1,467 crores.[72] It is obvious, therefore, that in terms of the magnitude of external resources that we can mobilize, private foreign capital can play only a minor role. The major role has, undoubtedly, to be played by foreign governments and international institutions.

Inter-governmental lending has become an important form of international assistance in recent years. If the 19th century witnessed the hey-day of international private capital movements, the present century can be rightly characterised as the crucible in which international institutions have been moulded to assume the role of a partial substitute for private capital. Together with these multilateral arrangements, the larger number of bilateral arrangements between lending and borrowing countries makes a vivid galaxy of instruments in international economic co-operation.

Before World War II, government-to-government

72. Reserve Bank of India, *Report on Currency and Finance*, 1960-61 (Bombay, 1961) 108.

aid occupied only a minor position in the pattern of international capital movements. For instance, the United States government had no international loans outstanding before World War II, except the World War I loans which were defaulted.[73] In the postwar period the United States government launched major foreign aid programmes which have assumed massive proportions in recent years. Originally designed as programmes for meeting emergency requirements and postwar reconstruction in Europe, the United States governmental aid gradually changed its character through continuous re-tooling. The Marshall Plan and the rearmament of Western Europe were viewed as temporary commitments. But soon it was realised that successful implementation of United States foreign policy objectives and the preservation of American interests abroad in general, would require continuous foreign economic and military support to friendly countries for an indefinite period. An important' policy statement which introduced the element of permanance into US foreign aid programmes was President Truman's 'Point Four' speech in July 1949. In his speech before the United Nations General Assembly on 22 September 1960, President Eisenhower expressed the need for long-term aid in the 'Five Point' programme he suggested for Africa.

One of the most significant developments in international economic relations in the postwar period, particularly from the mid-1950's, has been the emergence of socialist countries as an important source of economic assistance to underdeveloped countries and the continued reinforcement of this source. Of course, capital movements between the countries within the socialist bloc have been in operation for a long time. But, beginning in 1954 at modest levels, socialist aid to countries outside the bloc expanded at a significant rate, reaching about 1,367 million dollars during the fiscal year ending June, 1960. Compared to the fiscal year 1959, this signified an increase of about 75 per cent. The

73. United States, Department of Commerce, *Survey of Current Business* (May, 1954) 10.

total credits and grants, mainly for economic development, but including a small portion of military assistance, offered to about 21 underdeveloped countries, up to November 1960, amounted to 4.6 billion dollars. Even though this total is far below the total bilateral economic aid given by the United States between 1954 and 1959 amounting to 17.9 billion dollars, it is highly significant in terms of its rapid rate of growth.

A significant fact to be noted is that, unlike private capital, a substantial portion of public capital has gone into low-income underdeveloped countries.

Table 40

NET FLOW OF FOREIGN FUNDS TO UNDERDEVELOPED COUNTRIES BY INCOME-GROUP, 1950-59, ANNUAL AVERAGE.74

Income group	*Private long-term capital*	*Official grants and long-term capital*
	(Average ratio to gross domestic product)	
Countries with per capita income of		
(1) less than 100 dollars	—	2.3
(2) 100 to 199 dollars	1.0	1.3
(3) 200 to 299 dollars	1.3	1.1
(4) 300 dollars or above	1.7	3.3
Total: Underdeveloped countries	1.0	1.9

In countries with per capital income of less than 100 dollars, private foreign capital was conspicuous by its absence; but the deficiency was compensated by substantial loans and grants from foreign governments. About 22 per cent of the total flow of private capital during 1950-59 was to these countries in the lower income bracket.

The mobilization of foreign resources from bilateral sources involves considerations which have very little in common with the mobilization of private foreign capital. While the international flow of private capital is motivated largely by considerations of profit and other economic incentives such as export and import incentives, the flow of

74. United Nations, n. 60, 65.

resources on a government-to-government basis as inevitably linked with political and other non-economic forces.'[75]

A substantial portion of aid given by the United States is composed of military aid. This concentration of military aid started after the Korean War. During the five years preceding the Korean War, direct military aid amounted to only about 1.5 billion dollars out of the total foreign aid of 26 billion dollars. But during the six years following the Korean War, out of 30 billion dollars of United States foreign aid, about 17 billion, or about 60 per cent, went into direct military assistance.[76] In addition, part of the economic aid indirectly went into military support. After a study of United States foreign aid programmes, McClellan comes to the conclusion that the United States is 'not engaged in a large-scale programme to promote the development of underdeveloped countries'. What the United States now has 'is primarily and overwhelmingly a programme to subsidize our (United States') military alliances.'[77]

Considerations of foreign policy, particularly in relation to world communism, do enter the United States foreign aid programmes. Eugene Staley was reflecting the spirit of economic policies in the United States when he stated that, 'Strategic and military factors vital to the defence of the free world must therefore influence the allocation of part of the international development aid, provided by the United States and other countries'.[78] And for Douglas Dillon, the US Under-Secretary of State for Economic Affairs, 'the foreign aid programme was the major answer of the USA to the communist challenge in underdeveloped areas.'[79]

The consequence of this military and political reorientation of foreign aid programmes is that resources tend to be diverted to countries without reference to their relative

75. *Ibid.*, 66.

76. Grant S. McClellan, Ed., *U.S. Foreign Aid* (The H. W. Wilson Company, New York, 1959) 32.

77. *Ibid.*, 33.

78. Staley Eugene, *The Future of Underdeveloped Countries* (Harper, New York, 1954) 352.

79. Speech made by Douglas Dillion at San Fransisco on 7 November 1958—*The Hindustan Times* (New Delhi) 9 November 1958.

economic needs. Thus, 'the distribution of economic aid by the governments of the developed countries in the Western world has been very unequal, and bears little relevance to the actual economics of development.'[80]

No doubt, political implications are involved in all government-to-government aid, whether from the advanced capitalist countries or from the socialist countries. But the differences in the political implications of foreign aid from the two groups of countries is not merely differences in degree; but essentially qualitative ones. For instance, while the political implications of United States governmental aid, in many cases, involves direct political strings, the aid offered by Soviet Union has uniformly been devoid of any such direct strings. United States foreign policy objectives dictate the selection of friendly countries in the list of recipients of foreign aid. But since, in relation to United States military and political strategy abroad, 'friendliness' is defined specifically to mean military alliance or subserviance to political policy decisions of the United States government. This logic invariably prompts the United States government to attach 'visible or invisible military strings' to US foreign aid.[81] It is the same type of logic that compels the architects of foreign aid policy and programmes in the United States to put pressure on the recipient countries to conform to US foreign policy. For instance, the United States government has been 'reluctant and grudging in giving aid to India because she has refused to become an ally of the United States.'[82] On the other hand, as McClellan points out, 'the Russians attach no strings, military or other' to their foreign aid.[83]

The general criticisms of United States aid programmes, however, do not invalidate the utility of bilateral assistance. Two important conclusions follow. Firstly, bilateral assistance should be so designed as to facilitate the process of industrial growth particularly in priority industries such

80. Rao, n. 8, 20.
81. McClellan, n. 76, 44.
82. *Ibid.*, 47.
83. *Ibid.*, 47.

as basic and heavy industry sector. The British, German and Soviet steel plant agreements entered into by the Government of India can be considered as steps in the right direction since they directly strengthen the heavy capital base of the Indian economy.

Secondly, we have to reject any aid that stipulates political and economic privileges to the lending country. But we should be equally conscious of the fact that aid from any foreign government, whether it is the United States or the Soviet Union, has its own 'compulsions' even if the agreement contains no formal political strings. What a recipient country has to examine is whether the compulsions are strong enough to demand a change in accepted national policies or not. In other words, acceptance of aid from a foreign government must be consistent with our national interest and aspirations.

In this connection, the 'operational conditions' put forward by the United Nations Economic and Social Council can be taken as the guiding principles for the functioning of bilateral aid programme. The operational conditions are:

(i) the assistance should be so designed as to increase productivity in fields where benefit could be distributed to the entire population;

(ii) the assistance should not be misused as a means of foreign political or economic interference in the domestic affairs of the country receiving it.

The superiority of the United Nations as an instrument of economic assistance lies in the fact that political compulsions are reduced to the minimum.

Multilateral assistance is provided by the Technical Assistance Administration of the United Nations and its specialised agencies. The United Nations, through Article 55 and Article 56 of its Charter, place responsibility on member countries to help, both individually and in cooperative endeavour, the underdeveloped countries in their developmental effort. According to Resolution 200 (III), passed by the General Assembly in December 1948, provisions are made

(i) to arrange for teams of internatioal experts to visit

countries whose government request advice on economic development;

(ii) to provide fellowships for the training abroad of experts from under developed countries;

(iii) to arrange for the training of local technicians within the underdeveloped countries themselves; and

(iv) to assist governments to obtain technical personnel, equipment and supplies.

Attempts to spread technical know-how in the underdeveloped countries is undertaken by the United Nations Technical Assistance Programme. The WHO, the UNICEF and UNESCO, and the specialised agencies such as the International Monetary Fund, the International Bank for Reconstruction and Development, and the International Development Association set up in 1960, also provide assistance in various types in their respective fields. SUNFED (Special United Nations Fund for Economic Development),[84] the agency created by the United Nations attempts to mobilize funds for projects of a non-self-liquidating type such as education and social services.

The future of international capital movements rests largely on the developments in the lending countries. The rate of growth in income and the generation of economic surplus in these countries will determine, to a large extent, the magnitude of funds available to the less developed countries.

In discussing the future prospects of international finance, it will be wrong to group all the lending countries into one category. The division of the world economy, particularly of the industrialised countries, into capitalist and socialist camps, and the differences in the nature and growth of the productive forces between these two groups of countries make it imperative on our part to make

84. A resolution preparing the way for the creation of the Development Fund was adopted by the United Nations General Assembly's Economic and Financial Committee on the 29 November 1958. The resolution also asked the Secretary-General to prepare a report on channelling more private capital into underdeveloped countries 'under mutually accepted arrangements'.

separate studies on the prospects of international capital flows from these two groups of countries.

It is a significant point to note that the advanced capitalist countries which had maintained virtual monopoly over international trade and finance are today only one of the two alternative sources of international economic assistance. In the field of production of capital goods and technical know-how, capitalist countries no longer hold a monopoly. Again, the agricultural and primary producing countries in the underdeveloped part of the world are no longer in the difficult position of being compelled to export their goods to the advanced capitalist countries at unfavourable prices for the lack of alternative markets.

As the economic competition between the two world economic systems proceeds, the international capital flows from the capitalist and the socialist countries undergo qualitative as well as quantitative changes.

The quantitative changes in the international capital flows are, no doubt, influenced by the economic surpluses created in the advanced countries in the process of their growth. But a very significant factor which determines the quantum of international finance is the increasing competition between the two world economic systems, and the use of international economic assistance as a means of influencing the pattern of development in the underdeveloped areas.

The qualitative changes in international capital movements, brought about by the increasing competition between the two world economic systems, are largely a reflection of the qualitative differences in the relations of production in the two systems and the differences in the nature and organisation of the productive forces.

In the world capitalist system, important changes have taken place during last few decades and some of these changes will, no doubt, be reinforced during the coming years. Some of the changes are superficial and perepheral in character; but they pose new situations which cannot be understood adequately with any conventional frame of analysis.

It is argued, for instance, that American capitalism has

undergone basic changes and that the new trend towards large flow of American governmental aid to underdeveloped countries is a reflection of basic changes within the American economy in the direction of creating 'people's capitalism'.[85]

What has actually taken place in the United States is the growth of state monopoly capitalism, that is 'the combination of the forces of the monopolies and the state for a two-fold purpose: the preservation of the capitalist system and the redistribution of the national income through the state in favour of monopoly capital'.[86] The development of capitalism in the United States today is thus distinct from the state capitalism which is characteristic of some of the capitalist countries in the less developed areas.

The development of state monopoly capitalism in the United States has, no doubt, changed the character of United States investments abroad. The most significant change is, probably, the increasing role played by United States governmental aid in the overall export of American capital. This, however, does not signify a shift in the policy of the United States government away from the pre-eminence attached to private capital. On the other hand, the United States policy has throughout been placed on the 'primary reliance' on private capital.[87] 'Post-war policy of the United

85. The most vigorous exposition of this theory of 'American exceptionalism' occurred during the 1920's. The belief, widespread in the United States, was that American capitalism was basically different from European capitalism, that it was devoid of the evils of capitalism such as monopoly, colonialism and class contradictions. Protagonists of this theory actually lived in the Utopia—one of the short-lived Utopias—of 'people's capitalism' and 'labour capitalism'.

86. E. Varga, 'Twentieth Century Capitalism', *Mirovaya Ekonomika i Mezhdunarodnye Otnosheniia*, I, 1960, trans. in *Problems of Economics* III, 1, May 1960, 58.

87. The policy of 'primary reliance' on private international investment has been embodied in various documents of the United States Government and statements of Government spokesmen: (i) The policy underlying the Point Four programme was revealed in the testimony of the Under-Secretary of State, Webb, before the House Committee on Foreign Affairs, *Department of State Bulletin* (10 October 1949); (ii) Commission on Foreign Economic Policy, 1953, *Report to the President and the Congress* (Randell Commission Report) Washington, D.C., January, 1954) 18; (iii) President Eisenhower's Message to Congress, 10 January 1955; (iv) *Report*

States government has emphasised the desirability of private investment in foreign countries by American citizens as a means of achieving both domestic economic and foreign policy objectives.[88] And the United States government has adopted a series of positive measures to encourage the flow of American private capital abroad. But because of the relative stagnation in the international movement of private capital and also because of the resistence from some of the recipient countries to the penetration of private monopoly capital, the United States government cannot rely on private capital alone in fulfilling their objectives with regard to foreign economic policy. Thus, governmental aid to foreign countries has been designed as a major supplement to private capital.

An important manner in which American governmental aid to foreign countries seeks to promote the international movement of American private capital is with regard to the creation of economic and social overheads abroad. In many underdeveloped countries the inadequate growth of economic overheads such as transportation and communications, irrigation works, etc., described as the 'infra-structure', is a serious deterrent to private capital investments. The limited resources in the hands of most of the recipient countries' governments usually do not allow for a vigorous development of these overheads. And because of the low yields and the long maturity of such projects, private capital, particularly private foreign capital, is not attracted to these fields.[89] Hence, public capital from the United States

to the President on Foreign Economic Policies (Gordon Gray Report) Washington, D.C., November, 1950; (v) *Partners in Progress: A Report to the President by the International Development Advisory Board* (Nelson Rockefeller Report) March, 1951.

88. Raymond F. Mikesell, *Promoting United States Private Investment Abroad* (National Planning Association, Washington, D.C., 1957) I

89. During the 19th century, a significant portion of international investments went into these sectors. The performance of the foreign concerns in these fields were generally disappointing. Some of the significant failures of private enterprise during the hey-day of laissez-faire occurred in sectors such as railways and irrigation works. Consequently these sectors had to be developed under the direction and management of the state. India in the early British period is a case in point.

is exported to these underdeveloped countries as a prerequisite for successful American private investments and for strengthening private enterprise in general.[90]

Clarence B. Randell, one of the chielf architects of United States foreign economic policy, has been a strong advocate of such a strategy of 'joint ventures' of American private and public capital. He observed that

> ...there are always basic public facilities that are required in a developing region...American investors could hardly be expected to undertake these for profit. Yet to build them might immediately make possible enterprises that would be good business for us, and good progress for the other nation. For our government to make a loan under those conditions might be just as important in advancing our loan-term national interest as financing a road program within the United States.[91]

United States governmental aid, by raising the yield of American private capital abroad and thus ensuring higher income flows into the United States, contributes to the national income the United Sates.[92]

The role of public foreign capital in promoting private investments abroad is not limited to the creation of economic and social overheads. The ability of private concerns to establish and strengthen their monopoly positions in foreign countries today depends largely on the support given by its government through foreign economic and political policies. An elaborate system of government-to-government aid enables the lending country's government to influence the policy of the recipient country with regard to international private investments.[93]

90. It is important to note that the role of American governmental assistance in promoting American private investments abroad is actually a projection or logical extension of the role played by the American Government in promoting private enterprise within the American economy itself.

91. Randell, n. 27, 44-44. See also 147.

92. Charles Wolf, Jr., *Foreign Aid: Theory and Practice in Southern Asia* (Princeton University Press, Princeton, 1960) 280.

93. United States governmental action to promote the flow of private international investments was one of the recommendations of the Randell Commission. In the opinion of the Commission, 'The Government can and should give full diplomatic support to the acceptance and understanding abroad of the principles underlying the creation of a climate conducive to

In certain cases, the public funds made available by the lending country's government is directly or indirectly diverted to prop up private enterprise in the recipient countries. For instance, the United States government follows the policy of diverting a portion of the counterpart funds raised through the sale of American surplus commodities in the recipient countries under P.L. 480 in the form of local currency loans, via financial institutions, to private enterprises including American concerns.[93a]

Apart from the developments within individual capitalist countries, another factor which has immense relevance to the future of international investments is the economic relations among the advanced capitalist countries themselves. Will the United States, the greatest creditor country in the world today, remain so for the foreseeable future? Will the trend towards increasing inequalities between the advanced capitalist countries on the one hand and the underdeveloped countries on the other, distort the direction of international capital movements further towards its concentration in the advanced countries? Or will the operation of the law of uneven development of the capitalist countries be avoided through counterveiling measures adopted by these countries?

Definitive answers to the above questions are difficult as they depend upon a number of imponderables. However, two considerations which are relevant may be noted. First, the future of American capital flows to the underdeveloped countries will depend upon how successfully the United States meets the challenge posed by the Soviet Union in peaceful economic competition. Second, it will depend upon how the United States meets the increasing competition from other components of the capitalist system, particularly Western Europe and Japan.

The developments within the world socialist system which

private foreign investment. — United States, Commission on Foreign Economic Policy, 1953, *Report to the President and the Congress* (Randell Commission Report) Washington, D.C., January, 1954, 17.

93a. United States, Agricultural Trade Development and Assistance Act of 1954 (P.L. 480). See Title I of the Act.

have relevance to the future prospects of international finance are mainly two. Firstly, the economic growth of the socialist countries is taking place at a much faster rate than the growth of advanced capitalist countries. About the actual rates of growth in the socialist countries, however, there seems to be wide differences of opinion, mainly arising from the distrust of official statistics published by these countries. The attempts on the part of various individual researchers and agencies to correct official statistics and reconstruct the figures regarding rates of growth of the socialist countries have resulted in an array of estimates which complicates discussion on comparative rates of growth of socialist and capitalist countries. But a significant fact to be noted is that practically all these estimates, except those which are glaringly biased by political predilections, indicate a higher rate of growth for the socialist countries.

Estimates which are provided by the United Nations indicate that the average rate of growh during the 1950's in the Soviet Union was about three times that in the United States. The rate of growth in all the socialist countries were nearly 8 per cent and above. On the other hand, with the notable exception of West Germany and Japan, all the capitalist countries had rates of growth in income of nearly 4 per cent and below. While a rate of growth as high as 8 per cent and above is a rule so far as the socialist countries are concerned, the high growth rate of 9.1 per cent and 7.5 per cent for Japan and West Germany respectively seems more an exception.

A study prepared by the United States Library of Congress, Legislative Reference Service, estimated the Soviet rate of growth of industrial output during 1928-55 at about 7.7 per cent per annum compared to 3.6 per cent for the United States in the same period. During 1950-55, the estimate puts Soviet and United States industrial growth rate at 9.9 per cent and 4.4 per cent respectively.[94] Again, Joseph

94. United States, Library of Congress, Legislative Reference Service, *Soviet Economic Growth : A Comparison with the United States* (A Study Prepared for the Subcommittee on Foreign Economic Policy, 85th Congress, 1st Session) Washington, 1957, 23-24.

A. Kershaw places the Soviet rate of growth in the neighbourhood of 9 per cent per year and arrives at the 'inescapable' conclusion that 'the rate of increase in Soviet industry is at least double that in the United States'.[95] Robert W. Campbell, in his study of the Soviet economy gives an estimate of 4.3 per cent per year as the rate of industrial production in the United States economy during 1946-57 and 3.2 per cent per year for the longer period 1929-57. For the Soviet Union, he quotes the Hodgman index which shows a rate of growth of 8.9 per cent per year for 1928-55.[96] And if we take the US National Bureau Index, for the period 1950-55, the Soviet rate of industrial production is 10.2 per cent per year.[97]

The resultant of a higher rate of growth—a rate of growth described by Randell as 'formidable' and 'outstanding'[98] is that the Soviet Union which was far below the United States in respect of the absolute level of national and per capita income has today become a formidable economic power. The Soviet Union has surpassed the United States not only in terms of the rate of expanded reproduction, but also in terms of the absolute scale of increase in the social product in most of the important lines of production such as iron and steel, coal, petroleum and in important branches of machine building and in chemicals.[99]

A question of considerable importance for the future is whether the present rate of growth in the Soviet Union and other socialist countries will continue for an indefinite period. The study conducted by the United States Library

95. Joseph A. Kershaw, 'Directions for Future Growth of the Soviet Economy', *Study of the Soviet Economy*, Ed. by Nicolas Spulber (Indiana University, Bloomington, 1961) 8.

96. Robert W. Campbell, *Soviet Economic Power* (Houghton Mifflin Company, Cambridge, Massachusetts, 1960) 48-50.

97. This is to be compared with the official Soviet index for 1950-55 which gives 13.1 per cent as the annual rate of growth in industrial production. For Soviet official figures, see *Soviet Handbook, 1959—1965* (Soviet Booklets, No. 57, London, November, 1959) 19.

98. Randell, n. 27, 109-110.

99. N. 97, 20 and 64-65. See also Ya. Kronrod, 'Special features of socialist reproduction at its present stage', *Voprosy Ekonomiki* (No. 9, 1959) trans. in *Problems of Economics*, II, 8 (December, 1959) 10.

of Congress, Legislative Reference Service, in 1955, while projecting the rate of growth of the United States and Canadian economies during two decades from 1955 to be 4 per cent annually in terms of 1953 United States prices, forecasts a fall in the Soviet growth rate from 7 per cent during 1948-53 to between 4.5 per cent and 5 per cent during 1953-70.[100]

The expectation of a fall in the Soviet growth rate has, generally, been based on the proposition that an economy which starts economic growth from a very low base will exhibit a high percentage rate of growth for some time; but once the economy approaches maturity, the rate will invariably decline. Such a tendency which was characteristic of some of the advanced capitalist countries of today, does not seem to operate in the case of planned economies where a continued high growth rate is made possible through planned diversion of substantial resources into investment channels. As Joseph A. Kershaw had admitted, 'there is no obvious and inherent reason why substantial slowing down in the Soviet rate of growth should be expected to occur'.[101] It is not unrealistic to assume that the targets laid down by the Soviet planners for the coming decades will be fulfilled. According to the Soviet Seven Year Plan gross output in industry during the Plan period, 1958-65, will be 62 to 65 per cent, or about 8.6 per cent per annum.[102] The share of the Soviet Union in world industrial output, which was less than 3 per cent in 1957, rose to about 20 per cent in 1958. By the end of the Seven Year Plan, in 1965, all the countries in the socialist system together will account for about half of the world's total industrial production.

The second development which has relevance to the future prospects of international finance from the socialist

100. United States, Library of Congress, Legislative Reference Service, *Trends in Economic Growth : A Comparison of the Western Powers and the Soviet Bloc* (A Study Prepared for the Joint Committee on the Economic Report) Washington, 1955, 219.

101. Kershaw, n. 95, 10.

102. *Control Figures for the Economic Development of the U.S.S.R., 1959—1965* (Theses of N. S. Khrushchov's Report to the 21st Congress of the CPSU) Moscow, 1958, 33.

countries is that the economic integration within the world socialist system is taking place in a manner which reduces, at a significant rate, the economic inequalities among them. This is in direct contrast to the widening inequalities between the advanced capitalist countries and the less developed ones. While the working of the acceleration principle seems to have widened the income gap between capitalist countries, the operation of the principle of international socialist division of labour has enabled the lagging countries within the world socialist system to approach the income levels of the advanced socialist countries.

The first development, namely, the growth of socialist economies at a much faster rate than the capitalist countries, indicates the distinct possibility that larger and larger resources from the socialist countries will be available for financing economic development in other countries. The second development makes it possible for the resources for international assistance to be increasingly diverted to the underdeveloped countries in the capitalist segment of the world economy rather than being blocked up for assistance to the less developed countries within the socialist system itself.

Given the present trends in the international flow of capital, it can be confidently anticipated that the magnitude of external capital needed for India's development plans will be forthcoming. But it should be remembered that, even if all the conditions for the successful mobilization of foreign capital are satisfied and even if the country's capacity to attract it is the maximum, the final utilisation of such capital would depend upon the country's 'capacity of absorb' the capital available from abroad.

The capacity of a country to absorb foreign capital is not unlimited. The prevalent view among many economists that 'the more foreign capital we have, the better we would be', is based on an insufficient understanding of the capacity of a country to absorb external capital. Even if a country is assured an unlimited volume of foreign capital inflow, the country will not be in a position to use the promised resources beyond a certain limit. We may call this the

'upper limit' for the absorption of foreign capital into the domestic economy.

The upper limit of absorption is fixed by many factors such as (i) the capacity of the recipient country to raise complementary domestic resources, (ii) the capacity of the recipient country to shift to a new technology, (iii) the capacity of the recipient country to expand export operations in order to raise exchange resources for repayment and service payments, and (iv) the educational, social and political and administrative framework influencing the economic growth of the economy.

For every development project which a country undertakes, there are certain categories of resources which have to be mobilised from within the domestic economy. These resources may not be available from abroad. Similarly, there may be certain categories of resources, machinery, equipment and technical skill which have to be imported from abroad, depending upon the import content of particular projects. The volume of these external resources is determined by the volume of 'complementary domestic investments' in the development projects. As H. W. Singer observed:

> ... a flow of international investment into the underdeveloped countries will contribute to their economic development only if it is absorbed into their economic system, i.e., if a good deal of complementary domestic investment is generated and the requisite domestic resources are found.

Bottlenecks will inevitably appear if domestic outlay cannot be met by mobilization of domestic resources. For instance, the receipt of a foreign loan may enable a country to import locomotives and rolling stock for modernising and improving the country's railway network. But, the programme of railway improvement will run into difficulties if domestic resources cannot be raised in order to construct the railway track, stations, etc., and to provide for adequate and continued repairs.

As a general proposition, we may say that the capacity of a recipient country to absorb external capital is directly proportional to the capacity of the country to raise comple-

mentary domestic resources. Foreign investments cannot be absorbed into the domestic economy unless the necessary domestic investments are also simultaneously made.

The usual argument against this proposition is that these bottlenecks can be removed by further foreign borrowing in order to import more raw materials and consumption goods and release the pressure on domestic resources; but such substitutability cannot be assumed to be unlimited. Moreover, there will always be certain types of resources which have inevitably to come from within the domestic economy.

The absorptive capacity of a country may also depend upon the ability of the enterprise concerned to shift to a new technology represented by the new inflow of capital. A clear case of such technological limitation on absorptive capacity was offered by the coal industry in India in 1958. The United States Export-Import Bank had allocated credit of one million dollars to the private sector of the coal industry in India. But the industry could not utilise the credit to any appreciable extent. One of the main reasons for this inability of the coal industry to absorb the foreign credit was that the 'bulk of the existing machinery in the private collieries is of British manufacture' and that there was 'hesitation in switching over to unfamiliar American equipment and spares'.[103]

An equally important factor which determines the upper limit of a country's capacity for absorbing foreign capital is the ability to expand the country's export operations in order to raise the exchange resources necessary for service obligations and amortization.[104] As the United Nations report has observed with reference to Latin American countries, 'the capacity to absorb additional capital from abroad for purposes of economic development will also vary, depending on many factors, of which the potential expansion of export

103. *Hindustan Times* (New Delhi) 22 November 1958.

104. The Union Minister for Finance Morarji Desai stated at Bombay on 11 November 1958, that 'the Government were keen to see that they did not take any loans which were beyond their capacity to repay'.—*Hindustan Times*, 13 November 1958.

proceeds may be considered particularly important.'[105] The pressure on the recipient country's repayment position will be considerably reduced if some of the creditor countries agree to receive the investment income and amortization payments in the currency of the recipient country. Aid in the form of grants or 'soft loans' repayable in the local currency will, undoubtedly, increase the absorptive capacity of the recipient country.[106] But as the individual foreign investors and governments of creditor countries usually insist on repayment in the currency of the creditor countries, the capacity of the recipient country to absorb additional inflow of foreign capital will depend on the ability of the country to raise foreign exchange resources through the expansion of exports. Operationally, this may, in certain cases, mean the reorientation of a considerable sector of the domestic economy on export lines.

The social framework of the recipient country, the level of education and technical efficiency of the people[107], the political institutions and their stability, the competence and dynamism of the administrative apparatus which executes the development programmes, etc., have an important relationship to the capacity of a country to absorb foreign capital. In India and other underdeveloped countries, this assumes special significance. As most of the underdeveloped countries of South and South-East Asia were formerly under colonial rule, the emergence of a strong political and administrative framework in these countries becomes an important prerequisite for the successful operation of any development plan and for the proper absorption and utilisation of foreign capital.

105. United Nations, *Foreign Capital in Latin America* (New York, 1955) 15.

106. P. N. Rosenstein-Rodan, 'Economic Assistance Requirements of Underdeveloped Countries', *Economic Weekly*, Annual No., 4 February 1961, 223.

107. G. D. Birla, addressing industrialists of Calcutta on 9 November 1959, while expressing confidence in the availability of external resources to India, observed that 'it might not be possible for her (India) to make full use of them unless more engineers, technicians and managers were trained'.—*Hindustan Times*, 10 November 1959.

What will happen if foreign capital is imported into the country beyond the upper limit we have set? Assuming that the government or the planning authority has reached a stage where further mobilisation of real domestic resources is difficult or impossible, one possible method which they may adopt is inflationary financing. In other words, the utilisation of foreign capital beyond the upper limit of absorption will exert pressure on the internal economic organisation to adopt methods of inflationary financing. To this extent, we may say that the import of external resources, if resorted to beyond the absorptive capacity of a country will tend to be inflationary.

There is another aspect to this problem. The import of foreign capital beyond the maximum absorptive limit may create serious balance of payments problem for the country and it may find it difficult or impossible to service the foreign obligations and make payments for amortization. If the expansion of export operations do not keep pace with the increasing rate of capital inflow, the repayment capacity of the country may be reduced resulting in defaults. This will shatter the confidence of foreign lenders in the country's viability and will strike at the very root of its capacity to attract even the normal volume of foreign capital necessary for the development plan.

Thus, the magnitude of foreign capital in India will depend not only on the capacity of India to attract it, but also on the absorptive capacity of the Indian economy. From the trends in the capital inflow into India so far, it can be safely concluded that we have to rely more and more on public foreign capital compared to capital mobilised from private foreign sources. But, difficulties in raising complementary domestic resources, the difficulties in adapting to technological changes, and administrative bottlenecks are bound to affect India's capacity to absorb foreign capital to the desired extent and manner.

Chapter VI

Costs of Private Foreign investments

In economic literature one often comes across arguments in defence of private foreign capital on the assumption that profit transfers of foreign companies involve no real burden. Underestimation of the cost of profit transfers seems to be a very common error among economists.

The exact magnitude of the profits earned by the foreign sector is very often concealed by ingenious methods of keeping accounts designed primarily for getting a smaller squeeze in the income-tax offices. In the case of established firms of repute, this seldom takes the form of forgery; but the same objective is often served by the adoption of a system of cost accounting which gives the label of 'cost' to income-flows which in ordinary parlance mean investor's profit. These dubious ways of maintaining company accounts have resulted in a body of published literature on the profit and cost structure of the foreign sector which nourishes the innocent economist with a sense of sympathy and makes them veritable apologists of foreign private enterprise. However, there seems to be no ground for sustaining the apologetic attitude of these economists even if we accept the profit data supplied by the foreign companies.[1]

The transfer abroad of profits, dividends and interest on foreign capital involves a cost to the recipient country from two angles. Firstly, it involves a direct cost in the sense of a

1. As Dr. K. N. Raj remarked, 'The innocence of economists, no less than of politicians, about the facts of this foreign sector is remarkable, considering the amount of published material on the subject'—K. N. Raj, 'Model-making and the Second Plan', *Economic Weekly* (26 January 1955) Annual Number, 108.

deduction from the recipient country's total national income. Profits and dividends declared by domestic companies are retained in the country in one form or another; but in the case of a foreign company, a substantial portion of the profits are transferred to the investing country, thus causing a deduction from the total national product of the recipient country. Secondly, transfer abroad of investment income involves a cost because it is a drain on the foreign exchange resources of the country and creates a balance of payments problem. This is, no doubt, related to and an indirect effect of the direct cost mentioned above.

The significance of the direct cost incurred by India on account of the private foreign sector can be indicated in various ways. For instance, the investment income transfers may be expressed as a percentage of the net capital inflow. Another usefull method is to indicate the percentage share of the foreign sector in the total profits earned by all the private companies working in India.

The average annual net inflow of foreign capital (including investments in kind and reinvestments of profits), as we have already noted in a preceding chapter, was only about Rs. 20.8 crores during the period 1948-60. Against this relatively small annual net inflow of capital, the outflow of capital on account of profits and interest charges has been on an average level of Rs. 26.1 crores annually. In other words, the outflow of investment income has been greater than the net inflow of foreign private capital. The yearly break-up of these figures is given in Table 41.

As is clear from the table, except during 1960 the transfers abroad of investment income (profits, dividends, etc.) on private foreign capital account have been greater than the net inflow of private foreign capital. The divergence between investment income transfers and net capital inflow was particularly significant in 1954, 1955 and 1958. In 1958, net capital inflow was a very small figure of Rs. 2.4 crores while profits and dividends transferred abroad amounted to Rs. 25.4 crores. During the last decade, on the average, the investment income transfers have been greater than net capital inflow to the tune of Rs. 4.7 crores per year. This is

Table 41

INVESTMENT INCOME TRANSFERS IN COMPARISON TO NET CAPITAL INFLOW, 1948-60

(Rs. crores)

Year	*Investment income transfers*	*Net capital inflow*
July 1948-December 1953 (annual average)	23.6	22.0
1954 and 1955 (annual average)	34.3	14.9
1956	27.2	24.9
1957	25.6	17.9
1958	25.4	2.4
1959	23.3	11.0
1960	26.5	53.3
Annual average July 1948-December 1960	26.1	20.8

Sources: (i) *Reserve Bank of India Bulletin* (June, 1959); (ii) 'Foreign Investments in India: 1959 and 1960 (preliminary trends), *Reserve Bank of India Bulletin* (May, 1961) 676, and (October, 1962) 1533.

a very significant fact which is often conveniently forgotten by many economists and analysts while discussing the role of private foreign capital.

If we look into the figures for total profits of all the companies in India, it will be seen that a substantial portion of it is accounted for by foreign companies. The income of all companies in India after payment of taxes came to an average of Rs. 100.2 crores per annum during 1950-54. During the same period, the total profits of the foreign private sector amounted to about Rs. 40.7 crores annually. In other words, foreign companies and branches account for over 40 per cent of the total net profits of all companies in India.

It has been argued by many economists that foreign investments, in practice, do not involve the high cost of service payments which is usually attributed to them because a substantial portion of the profits is ploughed back into the industries and not transferred abroad.

The reinvestments of profits in industries in India, both

in the foreign and the domestic sectors, have not been insignificant. Statistics for 492 joint-stock companies in India shows that during 1946-51, these companies had net profits (i.e., profits after tax) amounting to Rs. 172 crores out of which Rs. 99 crores were distributed as dividends and the rest was retained in the companies.[2] This gave a percentage of 40 as the share of retained profits in total profits after tax. The amount of profits ploughed back into the industries by foreign investors, though not insignificant, has not been as remarkable as many people have tried to make out. The average rate of reinvestments in the private foreign sector during 1953-60 was to the tune of 32 per cent only. During this period, only in four years, 1954, 1956, 1959 and 1960 did the retention of profits in business take place to any significant extent.

Table 42

PROFITS OF FOREIGN CONTROLLED COMPANIES IN INDIA

(Rs. crores)

Year	*Total profits accruing to non-residents*	*Profits retained in business*
1953	37.7	11.5
1954	49.7	19.5
1955	42.8	4.4
1956	46.7	19.5
1957	35.1	9.5
1958	35.2	9.8
1959	38.6	15.3
1960	41.0	

Sources: (i) 'Foreign Investments in India: 1957 and 1958', *Reserve Bank of India Bulletin* (June, 1959) 661; (ii) 'India's Investment Income Liabilities Abroad, 1953-58', *RBIB* (August, 1960) 1077; (iii) 'Foreign Investments in India: 1959, and 1960 (preliminary trends)'; (iv) *RBIB* (May, 1961) 676; (v) *RBIB* (October, 1962) 1533.

It has to be admitted that, to the extent to which reinvestments take place, the immediate cost to the Indian

2. Government of India, *Report of the Taxation Enquiry Commission, 1953-54* (New Delhi, 1955) I, 125.

economy is diminished.[3] But the Indian experience clearly shows that the rate of investment income transfers, even after ploughing back part of the profits into the industry, is high enough to provoke serious concern about the cost involved. The investment income transferred abroad by the foreign concerns has to be considered as a deduction from the total national product, which retards India's capital formation and economic growth. Foreign investors draw away annually, in the form of profits and dividends, a considerable amount of surplus which India could divert for capital construction and for starting and expanding Indian enterprises.

The transfer abroad of investment income and the cost on that score differs according to (i) the form of foreign investment and (ii) the nature of the industry where the capital is invested. Private foreign investments take the form of equity capital or creditor capital. Investment income transfers and their effect on balance of payments differ significantly in the case of these two forms of private foreign investments. The nature of the industry refers to the nature of business activity in which the investors are engaged, whether it is an extractive industry or a manufacturing industry and so on.

As noted in a preceding chapter, the predominant portion of foreign private investments in India is in the 'direct' category. This is reflected in the investment income earnings. The bulk of profits accruing to the private foreign sector has gone to investors with direct equity holdings. The income earnings on portfolio holdings has been only about 9 per cent of total income earnings of the foreign sector during 1953-58. The following table (Table 43) gives details regarding the investment income liabilities of the private foreign sector with breakdown for direct and portfolio holdings.

3. This proposition is, of course, true only if we take a very short-term view. Taking a long-term view, it will be seen that to the extent to which retained profits inflate the total volume of foreign investments in India and consequently the quantum of profits in the future, reinvestments are an increasing burden on the Indian economy. This point is explained in another part of this chapter.

Table 43

INVESTMENT INCOME LIABILITIES ON PRIVATE FOREIGN CAPITAL ACCOUNT: 1953-58

(Rs. crores)

Year	*Portfolio investments*	*Direct investments*	*Total*
1953	33.0	3.5	36.5
1954	45.0	3.2	48.2
1955	38.2	2.9	41.1
1956	48.3	3.5	51.8
1957	36.9	4.3	41.2
1958	36.4	5.6	42.0

Source: 'India's Investment Income Liabilities: 1953-58', *RBI Bulletin* (August, 1960) 1076.

Note: Investment income liabilities should be distinguished from investment income transfers abroad. The former refers to accruals of income in any one period while the latter gives the amounts actually transferred abroad in that period. Out of the income liabilities in a particular year, only a part may be actually transferred abroad, the rest being either ploughed back into business or temporarily retained to be transferred in a future period.

The cost incurred by India in the form of profit transfers significantly varies according to the nature of the industry where foreign capital inflow takes place. Petroleum and tea plantations are two sectors where the profit margins have been exceptionally high. No doubt, the profit transfers have fluctuated over a period of years depending upon fluctuations in general business. In 1954 tea plantations accounted for about 47 per cent of total profits accruing to the private foreign sector. The share of the petroleum sector in total profits in the foreign sector in 1956 amounted to about 32 per cent. The profits accruing to the important sectors such as petroleum, manufacturing and tea are given in Table 44.

The experience of India and other underdeveloped countries shows that the profit margins in extractive industries, particularly the oil industry, tend to be spectacularly high. And these are precisely the sectors where foreign private capital has shown a tendency for fresh investments and expansion. The cost to the Indian economy in terms of income transfers is greater in these sectors, thus offsetting

Table 44

INVESTMENT INCOME PAYABLE ON PRIVATE FOREIGN CAPITAL ACCOUNT: SECTOR-WISE CLASSIFICATION

(Rs. crores)

Year	*Petroleum*	*Manufacturing*	*Tea*	*Others*	*Total*
1953	6.8	8.2	12.8	8.7	36.5
1954	7.7	9.5	22.4	8.6	48.2
1955	9.2	12.1	9.9	9.9	41.1
1956	16.4	14.1	11.1	10.2	51.8
1957	12.4	13.4	5.5	9.9	41.2
1958	11.1	17.1	5.1	8.7	42.0

Source: 'India's Investment Income Liabilities Abroad: 1953-58' *RBI Bulletin* (August, 1960) 1076.

whatever benefits that accrue from the operation of the foreign firms. As the *Economic Bulletin for Asia and the Far East* pointed out:

> If foreign capital is allowed to operate in fields where profit margins are more than ordinarily high, and completely take away the profits, the benefits to the country in employment, subsidiary industries and so on may prove in the long-run to be less than the cost.[4]

A significant fact to be noted is that the total investment income earnings of the private foreign sector in India is to a very large extent determined by the level of profits in tea plantations. Profits of foreign tea companies account for a sizable portion of the total profits of all private foreign companies. By 1953 the total foreign capital invested in tea plantations in India had reached Rs. 68.17 crores while the profits from these investments came to Rs. 13.29 crores, most of which was transferred abroad.[5] The profits of foreign tea companies were substantially high in 1954 when it reached a level of Rs. 21.5 crores. During 1955-60 total profits fluctuated between Rs. 5 crores and Rs. 11 crores. The following table (Table 45) gives the percentage share of the

4. 'Laws and regulations affecting foreign investments in Asia and the Far East', *Economic Bulletin for Asia and the Far East,* VII (United Nations, May 1957) 1.

5. Reserve Bank of India, *Report on the Survey of India's Foreign Liabilities and Assets as on* 31 *December* 1953.

profits of foreign tea plantations in the total profits of all foreign business investments in India during 1954-60:

Table 45

SHARE OF FOREIGN TEA COMPANIES IN THE TOTAL PROFITS EARNED BY ALL FOREIGN BUSINESS ENTERPRISES IN INDIA

(Rs. crores)

Year	*Profits earned by foreign tea companies*	*Profits earned by all foreign enterprises in India*
1954	21.5	49.7
1955	9.5	42.8
1956	10.7	46.7
1957	5.3	35.1
1958	4.9	35.2
1959	5.7	38.2
1960	6.7	41.0

Sources: 'Foreign Investments in India: 1957 and 1958', *RBI Bulletin* (June, 1959) 661; (ii) *RBI Bulletin* (October, 1962) 1533.

If we calculate the total amount of profits and dividends transferred abroad so far, it will reveal the fact that in every five years an amount almost equal to the total capital invested in the tea plantations is being transferred abroad in the form of profits and dividends. India has, in fact, paid to the foreign investors many times the capital invested by them in the tea plantations.

The cost of private foreign investments is particularly significant if we compare it with the cost of public foreign capital. The interest payments on the loans received by the Government of India from foreign governments and international agencies is much smaller than the profits accruing in the private foreign sector. The relative positions of the private foreign sector and the public foreign sector can be gauged from Table 46.

It is important to note that the investment income payments of public foreign capital is between 1.5 per cent and 3 per cent while the payments of the private sector is between 7 per cent and 11 per cent. The difference in cost will be more glaring if the figures were adjusted for certain imperfections in the data. For example, the figures for

Table 46

INDIA'S INVESTMENT INCOME LIABILITIES, 1953-58

(Rs. crores)

	Private foreign sector			*Public foreign sector*		
Year	*Total obligations outstanding*	*Investment income liabilities*	*Percentage*	*Total obligations outstanding*	*Investment income liabilities*	*Percentage*
1955	456.0	41.1	9.0	200.8	5.2	2.6
1956	492.8	51.8	10.5	224.7	5.4	2.4
1957	541.7	41.2	7.6	462.8	8.0	1.7
1958	570.6	42.0	7.4	693.2	13.3	1.9

Sources: (i) 'India's Investment Income Liabilities Abroad: 1953-58, *RBI Bulletin* (August, 1960) 1075-82; (ii) 'Foreign investments in India: 1959 and 1960 (Preliminary trends)', *ibid.*, (May, 1961) 674, 680.

total obligations outstanding in the private sector actually includes the loans received by private industries from international agencies such as the World Bank[6]. The comparatively low percentage of profits to outstanding obligations in 1957 and 1958 is, therefore, partly due to the inclusion of such loans in the data.

The impact of foreign investments on the balance of payments of a recipient country is not readily amenable to quantitative measurement. The relationship between the two is not only complex, but also, very often, of an indirect nature.

It is generally argued that, from the point of view of a recipient country, the economic justification for foreign investments, is the possible increase in domestic production over and above the investment income transfers. This generalisation, however, cannot be taken as an adequate criterion for giving entry and authorisation to foreign capital. The role of foreign capital is not limited to additions in output

6. Foreign investmtents in the private sector from official sources abroad amounted to Rs. 14.8 crores, Rs. 46.9 crores and Rs. 72.2 crores in 1956, 1957 and 1958 respectively.

and income, but covers a number of factors such as foreign economic concentration, heavy transfers of investment income and adverse effects on balance of payments.

The objective of comprehensive industrialisation which India has set forth in her five year plans involves special import needs and consequently many difficulties in her balance of payments. The Planning Commission observed that 'the Second Five Year Plan with the substantial stepping up of aggregate investment that it envisages and its stress on industrialisation will involve a heavy strain on foreign exchange reserves'.[7] The same stress and strains are expected to continue in the Third Plan period and possibly in many subsequent plans also.

The balance of payments problem arises due mainly to three reasons. First, the development plans result in higher imports. To execute the programme of industrialisation more machines and intermediate goods have to be imported. Since most of these products are not available in the domestic market, the import of these items becomes an absolute necessity. In other words, our programme of industrialisation gives a direct stimulant to greater inports. Second, imports are a function of income. The development programmes which we undertake necessarily involve heavy investment expenditure which increases the aggregate money income in the country. This, in turn, generates further demand for goods, part of which will inevitably be for foreign goods. Thus, imports tend to increase depending upon the propensity to import. In the absence of strict and complete control over imports, there will be an increase in the volume of foreign goods imported into the country (both by way of increase in the volume of presently imported goods and by way of imports of new commodities). This increase in imports through an indirect stimulant may be called the induced increase in imports.

Third, there is the possibility that the country's exports may fall as a result of industrialisation. It is true that, to the extent to which industrialisation induces expansion in

7. Planning Commission, *The Second Five Year Plan*, 194.

export industries, there will be an increase in exports. But against this possibility there is the danger that industrialisation may proceed in a manner which may reduce exports. This happens when raw materials and consumption goods which were hitherto exported are domestically absorbed due to increased demand of domestic industries for these raw materials and the increased consumption needs of the people which follow higher incomes. The problem created by the domestic absorption of export goods will be further aggravated if part of the labour force engaged in the export sector shifts to new projects catering for domestic needs.

The effects of foreign investments on India's balance of payments has to be studied in the above setting. As a general proposition, it can be stated that, given the net receipts of foreign exchange through capital inflows and outpayments, the necessary conditions for maintaining a strong balance of payments position is that foreign investments should raise domestic production and enable the recipient country to improve its balance of trade at least by the amount of investment income transferred (debt service payments) abroad. If, as a result of the import of capital from foreign countries, the payments position of the recipient country is weakened, we can conclude that it constitutes a cost to its economy. To the extent to which the foreign capital invested in a country is received on a grant basis, the strain on the borrowing country's economy will be reduced.

The changes in the inflow of foreign capital and the outflow of investment income and the repatriation of capital have certain implications for India's balance of payments. Other things being the same, any variation in the capital movements to and from India will either lead to an improvement or a deterioration in India's balance of payments. The inflow of foreign capital will strengthen India's balance of payments and the outflow of capital and investment income will weaken that position. However, as a long-term perspective, these conclusions will have to be qualified, as we shall see later.

From the point of view of balance of payments, foreign investments have an equally important impact on the eco-

nomy of a recipient country, that is, through export promotion and import replacement. To the extent to which the industries started by foreign capital help to reduce our dependence on imports, there is a favourable effect on India's balance of payments. Similarly, to the extent to which foreign investments induce, directly or indirectly, our exports, there will be a favourable effect on our balance of payments. Conversely, to the extent to which foreign investments increase our imports or reduce our exports, there will be an adverse effect on our balance of payments, and hence a cost to the Indian economy.

For maintaining a strong balance of payments position productivity of foreign capital is a necessary condition. Resources received from abroad should be directed exclusively for productive ventures which raise the output and income of the country. It means the conscious direction of investments and the setting up of a machinery for ensuring the optimum use of these resources.

Productivity of foreign capital, though a necessary condition, is not a sufficient condition. Mere productivity of foreign resources does not guarantee the ability of the recipient country to meet the payments obligations. What is needed is that foreign capital should go into productive channels in the country, and together with domestic investments, improve the country's foreign exchange receipts to a level sufficient to meet the servicing of the obligations and the ultimate repayment of the debt.

In a predominantly private enterprise economy, the balance of payments effect of investment projects is not likely to be a dominant consideration in investment decisions. The private investors, both in the domestic and foreign sectors in the country, undertake industrial ventures primarily on the basis of profit prospects. The possible repercussions of their operations on the balance of payments of the country is seldom an important criterion of investment. But for a country aiming at socialism, investment decisions in the private sector, particularly in the private foreign sector, cannot be left to the anarchy of individual choice.

The balance of payments problem of a country is determined not only by the aggregate volume of investment, domestic and foreign, but also by the nature and direction of these investments. In the case of private foreign investments, there is a fundamental difference between equity investments and portfolio investments. The investment income which equity investments can transfer abroad vary in direct proportion to the profits that they create (assuming that reinvestments do not take place). Equity investments, in other words, do not impose a fixed burden on the recipient country in the matter of servicing the foreign obligations. On the other hand, the investment income transferred abroad by portfolio investments represents a fixed amount depending upon the rate of interest agreed upon in particular loan agreements. The service changes are therefore rigidly fixed and have no relation to the variations in profit earnings of the industry.

The rigid and fixed nature of the service payments of portfolio investments has been cited by many economists to substantiate their view that portfolio investments are disadvantageous to the recipient countries. It is argued that during the downswing of a trade cycle, the debtor country will be subject to the severe strain of the foreign exchange needs of the foreign loan service.

It is true that, in the case of a country which has occasional booms and slumps, the service payments on equity investments tend to vary directly with the level of business activity in the country involving large and unrestricted profit transfers during the period of prosperity and comparatively insignificant and restricted transfers during depressions.[8] In a period of depression the rigidity of service payments may be a disadvantage to many recipient countries.

The general advantage of flexibility has been attributed

8. In the case of the United States, some economists have shown, basing their argument on the experience in the inter-war period, that compared to American investments abroad in the form of loans, direct investments were not subject to business cycle to any great extent.—Hall B. Lary, *The United States in the World Economy* (Washington, 1943).

by some economists to equity foreign investments in India also. For example, the Bernstein Report on India deduced this conclusion on the basis of analysis of India's profit remittances and export receipts in the years 1951 and 1952.[9] Taking a very limited data covering only two years, it was shown by the report that the net liability on investment income account registered a fall along with a fall in export earnings. The year 1951 was a year of high prices and high export earnings. As against a total of Rs. 7 million of export earnings, net transfers of investment income came to a figure of Rs. 23.9 crores. The following year, that is 1952, witnessed a fall in prices and export earnings. The fall of export receipts to Rs. 6.1 billion was accompanied by a fall in net transfers of investment income to Rs. 10.4 crores.

The Bernstein Report was no doubt handicapped by the then existing limitations of the available data on investment income remittances. Even though the now available data also points to the tendency of export receipts and profit remittances to move in unison during a number of years, there have been exceptions to this general pattern. For example, in 1952 export receipts were lower compared to 1951 and profit remittances also showed a downward trend. On the other hand, while export receipts decreased in 1958 compared to 1957, profit transfers recorded a slight increase. The fluctuations in export receipts and profit remittances are shown in Table 47.

Export receipts and investment income transfers moved in the same direction in a number of years during 1950-58. The correlation between the two is positive but not very significant. By using methods of simple correlation, the coefficient of correlation has been calculated as +0.16. This is a very low coefficient which is statistically not very significant.

The general tendency of investment income transfers to fluctuate along with changes in export receipts does not

9. E. M. Bernstein, *Economic Development with Stability (A report to the Government of India by a Mission of the International Monetary Fund)* (New Delhi, 1954) 81.

Table 47

FLUCTUATIONS IN EXPORT RECEIPTS AND PROFIT REMITTANCES

Year	*Export receipts*	*Transfer abroad of investment income*
1950	556.1	30.7
1951	749.5	31.5
1952	649.1	27.5
1953	530.8	30.0
1954	548.8	26.7
1955	652.5	33.0
1956	629.9	26.8
1957	696.6	25.2
1958	564.3	25.4

amount to any significant benefit to a debtor country. This is because the reduction in profit transfers during a period of depression is insignificant in comparison to the huge reduction in export receipts. As can be seen from the preceding table, India's investment income transfers in 1952 were lower by Rs. 4 crores than that in 1951. But the reduction in export earnings was to the tune of about Rs. 100 crores. The net effect on the balance of payments was, therefore, negative. The fluctuating tendency of investment income transfers of equity foreign investments has little relevance so far as overall balance of payments is concerned.

There is another aspect to this question. Since India does not experience violent changes in the level of business activity, the advantages of equity investments through a smaller and restricted outflow of investment income (at times of business depression) seems to be insignificant. On the other hand, the developmental effort being carried out by India through the five year plans and concerted attempts at deliberate industrialisation would tend to keep a comparatively steady increase in business activity. This would, in turn, give equity investments an economic base for earning higher and higher profits to be transferred to the investing countries. A steady rise in investment and income in the country is likely to be followed by a more or less steady rate of profit remittances. Thus, the qualitative difference between equity and portfolio investments in the matter of

service payments is likely to be minimised. With relatively assured business prosperity the service payments of foreign equity investments tend to increase as a function of time, thus incurring an increasing cost to the Indian economy. It can be concluded that, for countries such as India which do not experience violent fluctuations in their level of business activity, it is advantageous to encourage private loan capital from abroad since the cost of service payments of such capital is lower than the cost of service payments of equity investments.

The continuous outflow of capital in the form of profit and interest transfers has serious foreign exchange implications. Particularly in the period of industrial development in India, we cannot brush aside the burden of service payments. The payment of investment income and repatriation of capital would require the Indian economy to set aside part of the future output and part of the future foreign exchange resources for these purposes. Unless economic development in India as a result of the investment of foreign capital increases the economy's total output and improves the balance of payments position by at least the cost incurred in servicing the obligations, it will be a burden on the economy.

For studying the burden of service payments an index which is generally used is the ratio of investment income to total export proceeds. Another ratio which can be employed in determining the burden of service payments is the 'investment service ratio', that is the ratio of investment income transfers to the country's total receipts of foreign exchange from current transactions. Unlike the 'investment income-export proceeds ratio', the investment service ratio takes into account not only the trade account, but also services and other invisible items.

The use of the investment service ratio in the discussions on the balance of payments effect of foreign investments is important because it gives due emphasis to current account earnings. In many recipient countries, whose exports are inelastic, it may be possible to increase foreign exchange earnings through other current account transactions. The

investment service ratio would, in such cases, be reduced, lowering the burden on the balance of payments.

The burden which India had to shoulder on account of service payments in the past was often heavy. The net interest and dividend charges which India had to pay in 1931 amounted to £25 millions.[10] The value of Indian exports near about that year (that is in 1928) was £223 millions, which gives the ratio of service charges to export proceeds of 11.2 per cent. The changes that have taken place in India's payments position on foreign investment income account during 1950-58 are shown in the following table.

Table 48

BURDEN OF SERVICE CHARGES ON INDIA'S PRIVATE CAPITAL ACCOUNT, 1950-58
(Rs. crores)

Year	*Payments for investment income*	*Export receipts*	*Total current account receipts (excluding official donations*	*Investment income —export proceeds ratio*	*Investment service ratio*
				(Percentage)	
1950	30.7	556.1	675.9	5.5	4.5
1951	31.5	749.5	860.0	4.2	3.7
1952	27.5	649.1	770.9	4.2	3.6
1953	30.0	530.8	645.8	5.7	4.7
1954	26.7	548.8	675.5	4.9	3.9
1955	33.0	652.5	824.1	5.1	4.1
1956	26.8	629.9	819.2	4.1	3.3
1957	25.2	696.6	892.9	3.6	2.8
1958	25.4	564.3	772.5	4.5	3.3

Sources: (i) International Monetary Fund, *Balance of Payments Year-Book* (all relevant issues); (ii) 'Foreign Investments in India: 1959 and 1960 (preliminary trends)' *RBI Bulletin* (May, 1961).

The investment income payments as a percentage of the total export receipts has remained within the range of 3.5 to slightly above 5.5 per cent. The investment service ratio also has been fluctuating in more or less similar degree and in similar direction. There seems to be no basis at all to

10. Royal Institute of International Affairs, *The Problem of International Investment* (London, 1937) 223.

sustain the popular belief that since our export earnings are likely to increase slowly but steadily, the transfer abroad of investment income will involve a decreasing burden on the balance of payments.

It should be noted that the two ratios mentioned above are not perfect indices of the burden of service payments. Since India is experiencing deficits in the balance of payments and since payments on developmental imports have to be made irrespective of our export performance, it is imperative on our part to conserve foreign exchange resources to the maximum extent possible. The service charges of private foreign investments assume serious proportions when we relate it to the scarce foreign exchange resources at our disposal.

India's liability on investment income account is likely to deteriorate in the future because of the tendency of the earnings from India's foreign assets to show a declining trend. The earnings on foreign assets, for example, amounted to about Rs. 17 crores in 1953 which was less than half the total investment income transfers abroad in that year. The margin between outgoings and incomings of investment income is likely to widen in the future, thus aggravating the problem of balance of payments.

If a country proposes to borrow funds from abroad for a considerable period of time, it is likely that the balance of payments position will pass through two stages: (i) a stage where fresh inflow of capital exceeds the outpayments for profits, interest and amortization or repatriation, and (ii) a stage where outpayments for service obligations exceeds fresh inflow of capital. In other words, the debtor country's balance of payments after a stage shows a net capital outflow.[11] The changes that take place in a country's debtor-

11. In the case of Latin American countries, the tendency of investment income transfers to exceed the capital inflow was evident in the 1920's. The total capital inflow into these countries was only one-third of the total outpayments on investment income account. Against a capital inflow of 200 million dollars from the United States, the transfers of investment income to the United States from the Latin American countries amounted to about 300 million dollars (United Nations, *Foreign Capital in Latin America*, New York, 1955, 15).

creditor position depends upon a number of variables such as, (1) the rate of profits or interest on the capital invested, (2) the ratio of reinvested profits to total profits earned, (3) the amortization schedule of the invested capital, and (4) the rate of fresh capital inflow.

Usually, ploughing back of profits is considered to be a favourable phenomenon from the point of view of balance of payments. Since reinvestment of profits means a reduction in the amount of profits transferred abroad, there is reason to take this view. However, the phenomenon can be looked at from a different angle also. Reinvestments are considered as a form of capital inflow; but this form of capital inflow does not bring with it any gain in foreign exchange earnings of the recipient country. While the claims of non-residents against India increases (on the basis of which increased dividends will be paid in the future), the recipient country's foreign exchange earnings are not strengthened in a positive way. As the ratio of reinvestments to total capital inflow increases, the gains in foreign exchange diminish. If this process continues, a point in time will be reached when substantial outpayments for dividends and profits will exceed new gains in foreign exchange through fresh capital inflow.

From a short-term point of view, no doubt, reinvestment of profits means a reduction in the investment income transferred abroad, and therefore, a reduction in the strains on the balance of payments. But in the long run, reinvestment of profits would increase the capital stock of the foreign firms, thus enabling them to transfer larger profits abroad later. Though reinvestment is a form of capital inflow, it does not help the country to meet the payments obligations on investment income account because reinvestments do not add to the country's foreign exchange receipts. In other words, the phenomenon of reinvestment is not an unmixed blessing.

The impact of private foreign capital on the balance of payments of a recipient country can be studied by the following hypothetical example. Let us assume that invest-

ment income amounts to 14 per cent out of which half is repatriated abroad and the other half is reinvested in India. We further assume that repatriation takes place every year at the rate of 5 per cent. We shall take three cases in which the total fresh capital inflow during a 15 year period shall be the same, that is, Rs. 15,000; but the rate of inflow of capital differs in the three cases. For our analysis it is actually sufficient to consider a case which is generally accepted as one of the most favourable cases from the point of view of balance of payments, namely, the case of a continuously increasing rate of capital inflow. If it can be demonstrated that even in this favourable case foreign capital would adversely affect the recipient country's balance of payments, the same conclusion can be deduced with greater force in the case of constant rate of capital inflow, or declining or fluctuating rates of capital inflow. However, all the possible cases are discussed here for the sake of elaborate demonstration. The following tables (Tables 49, 50, 51) show the different rates of capital inflow and their effect on the balance of payments of the country.

The results obtained in the preceding pages only reaffirm a basic truth about private foreign capital, namely that, unless the yield on outstanding investments declines to a significant extent, the total transfer abroad of investment income will outstrip, in the long run, the inflow of foreign capital. As the stock of foreign capital in the country increases, the profits and dividends declared on the total outstanding investments increase substantially, thus exceeding the new addition to the capital stock. The profit transfers are cumulative as the total book value of foreign investments increases. The phenomenon of profit transfers surpassing the fresh capital inflow is inevitable if we take a sufficiently long period.

It is important to note that the above observation is contrary to the optimistic expectation of many economists that if a country can get an ever increasing inflow of foreign capital, the balance of payments difficulties will not arise. Simple arithmetic would suffice to demonstrate that, in the long run, even the steadily increasing inflow of foreign capi-

Table 49

CASE I. IMPACT OF A CONSTANT INFLOW OF FOREIGN CAPITAL ON THE BALANCE OF PAYMENTS

(Rs. crores)

Years	*Fresh capital inflow*	*Total capital in the beginning of the year: (7) of previous year plus (2) of current year*	*Repatriation at the rate of 5%*	*Investment income at the rate of 14%*	*Reinvestments of profits*	*Total book value of foreign investments at the end of the year: (3)+(6)−(4)*	*Transfer abroad of investment income*	*Total out-payments for service charges and repatriations: (4)+(8)*	*Net results on the capital account of the balance of payments: (2)−(9)*
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1	100	100.00	5.00	14.00	7.00	102.00	7.00	12.00	88.00
2	100	202.00	10.10	28.28	14.14	206.04	14.14	24.24	75.76
3	100	306.04	15.30	42.85	21.43	312.17	21.43	36.73	63.27
4	100	412.17	20.61	57.70	28.85	424.41	28.85	49.46	50.54
5	100	524.41	26.22	73.42	36.71	534.90	36.71	62.93	37.07
6	100	634.90	31.75	88.89	44.45	647.60	44.45	76.20	23.80
7	100	747.60	37.38	104.66	52.33	762.55	52.33	89.71	10.29
8	100	862.55	43.13	120.76	60.38	879.80	60.38	103.51	−3.51
9	100	979.80	48.99	137.17	68.59	999.40	68.59	117.58	−17.58
10	100	1099.40	54.97	153.92	76.96	1121.39	76.96	131.93	−31.93
11	100	1221.39	61.07	170.99	85.50	1245.82	85.50	146.57	−46.57
12	100	1345.82	67.30	188.41	94.21	1372.72	94.21	161.51	−61.51
13	100	1472.72	73.64	206.18	103.09	1502.17	103.09	176.73	−76.73
14	100	1602.17	80.11	224.30	112.15	1634.21	112.15	192.26	−92.26
15	100	1734.21	86.71	242.79	121.40	1768.90	121.40	208.11	−108.11
	1500								

Table 50

CASE II. IMPACT OF AN IRREGULAR INFLOW OF FOREIGN CAPITAL ON THE BALANCE OF PAYMENTS
(Rs. crores)

Years	*Fresh capital inflow*	*Total capital at the beginning of the year : (7) of previous year plus (2) of current year*	*Repatriation at the rate of 5%*	*Investment income at the rate of 14%*	*Reinvestments of profits*	*Total book value of foreign capital at the end of the year : (3)+(6)−(4)*	*Transfer abroad of investment income*	*Total outpayments for service charges and repatriation : (4)+(8)*	*Net results on the capital account of the balance of payments : (2)−(9)*
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1	100	100.00	5.00	14.00	7.00	102.00	7.00	12.00	88.00
2	150	252.00	12.60	35.28	17.64	257.04	17.64	30.24	119.76
3	50	307.04	15.35	42.98	21.49	313.18	21.49	36.84	13.16
4	20	333.18	16.66	46.65	23.33	339.85	23.33	39.99	−19.99
5	50	389.85	19.49	54.58	27.29	397.65	27.29	46.78	3.22
6	100	497.65	24.88	69.67	34.84	507.61	34.84	59.72	40.28
7	80	587.61	29.38	82.27	41.14	599.37	41.14	70.52	9.48
8	150	749.37	37.47	104.91	52.46	764.36	52.46	89.93	60.07
9	100	864.36	43.22	121.01	60.51	881.65	60.51	103.73	−3.73
10	150	1031.65	51.58	144.43	72.22	1052.29	72.22	123.80	26.20
11	180	1232.29	61.61	172.52	86.26	1256.94	86.26	147.87	32.13
12	200	1456.94	72.83	203.97	101.99	1486.10	101.99	174.82	25.18
13	100	1586.10	79.31	222.05	111.03	1617.82	111.03	190.34	−90.34
14	50	1667.82	83.39	233.49	116.75	1701.18	116.75	200.14	−150.14
15	20	1721.18	86.06	240.97	120.49	1755.61	120.49	206.55	−186.55
	1500								

Table 51

CASE III. IMPACT OF A STEADILY INCREASING INFLOW OF FOREIGN CAPITAL ON THE BALANCE OF PAYMENTS

(Rs. crores)

Year	*Fresh capital inflow*	*Total capital in the beginning of the year: (7) of previous year plus (2) of current year*	*Repatriation at the rate of 5%*	*Investment income at the rate of 14%*	*Reinvestment of profits*	*Total book value of foreign investments at the end of the year: (3)+(6)−(4)*	*Transfer abroad of investment income*	*Total outpayments for service charges and repatriation: (4)+(8)*	*Net results on the capital account of the balance of payments: (2)−(9)*
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1	30	30.00	1.50	4.20	2.10	30.60	2.10	3.60	26.40
2	40	70.60	3.53	9.88	4.94	72.01	4.94	8.47	31.53
3	50	122.01	6.10	17.08	8.54	124.45	8.54	14.64	35.36
4	60	184.45	9.22	25.82	12.91	188.14	12.91	22.13	37.87
5	70	258.14	12.91	36.14	18.07	263.30	18.07	30.98	39.02
6	80	343.30	17.17	48.06	24.03	350.16	24.03	41.20	38.80
7	90	440.16	22.01	61.62	30.81	448.96	30.81	52.82	37.18
8	100	548.96	27.45	76.85	38.43	559.94	38.43	65.88	34.12
9	110	669.94	33.50	93.79	46.89	683.33	46.89	80.39	29.61
10	120	803.33	40.17	112.47	56.24	819.40	56.24	96.41	23.59
11	130	949.40	47.47	132.92	66.46	968.39	66.46	113.93	16.07
12	140	1108.38	55.42	155.17	77.59	1130.56	77.59	133.01	6.99
13	150	1280.56	64.03	179.28	89.64	1306.17	89.64	153.67	−3.67
14	160	1466.16	73.31	205.26	102.63	1495.49	102.63	175.94	−15.94
15	170	1665.48	83.27	233.17	116.58	1698.81	116.59	199.86	−29.86
	1500								

tal will not be in a position to withhold the impact of rapidly increasing volume of service payments.

The peculiar tendency of foreign capital to register adverse repercussions on the balance of payments of recipient countries only highlights the limited usefulness of foreign capital for the recipient country. The tendency of foreign firms to plough back part of their profits into the industry does not remove this defect because reinvestments of profits will make additions to the capital stock and larger profits and dividends will be declared on a much larger capital, thus making the investment income payments cumulative.

Having seen the possible impact of private foreign capital on the balance of payments of a recipient country in general terms, let us verify this phenomenon in the case of private foreign capital in India. The following table (Table 52) gives figures for the inflow of foreign capital, the rate of repatriation that has taken place in the foreign sector, the transfer abroad of investment income after ploughing back certain portion of the total profits earned by the foreign firms, etc. The effects of foreign capital on the balance of payments are looked at strictly from the point of view of capital inflows (additions to foreign exchange resources) and outflows (deduction from foreign exchange resources). The conclusions drawn from this partial analysis, no doubt, will have to be qualified by other equally important considerations.

The above table clearly shows that, on the capital account, the net result on the balance of payments has been a continuously negative figure during the entire period 1948-59. Columns 2, 3 and 7 indicate the three main methods through which the growth of private foreign investments in India takes place, namely, (a) inward cash transfers, (b) investments in kind, and (c) reinvestments of profits. Actually, on the first method, that is, the inflow of foreign funds in the form of cash transfers contribute directly to our foreign exchange resources. If we take into consideration only this form of direct receipt of foreign exchange resources, it will be seen that the adverse effects on India's balance of payments on account of the inflow of private

Table 52

IMPACT OF FOREIGN PRIVATE CAPITAL INFLOW ON INDIA'S BALANCE OF PAYMENTS

(Rs. crores)

Years	*Gross inward cash transfers*	*Foreign investments in kind*	*Total fresh capital inflow (2)+(3)*	*Repatriation*	*Investment income*	*Reinvestment of profits*	*Transfer abroad of investment income: (6)−(7)*	*Total out-payments for service charges and repatriation: (5)+(8)*	*Net results on balance of payments, taking cash transfers only: (2)−(9)*	*Net results on balance of payments, taking cash transfers and investments in kind: (4)−(9)*
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
July 1948-December 1953 (annual average)	6.0	15.1	21.1	9.1	36.3	12.7	23.6	32.7	−26.7	−11.6
1954 and 1955, (annual average)	1.5	6.4	7.9	5.0	46.3	23.0	23.3	39.3	−37.8	−31.4
1956	3.1	8.5	11.6	6.3	46.7	19.5	27.2	33.5	−30.4	−21.9
1957	5.9	11.4	17.3	9.1	35.1	9.5	25.6	34.7	−28.8	−17.4
1958	4.8	12.3	17.1	24.4	35.2	9.8	25.4	49.8	−45.0	−32.7
1959	3.3	7.2	10.5	14.8	38.4	15.1	23.3	38.1	−34.8	−27.3
1960	6.2	41.8	48.0	9.1	41.0	14.5	26.5	35.6	−29.4	+13.4

Sources: (i) Reserve Bank of India, *Report on the Census of Foreign Liabilities and Assets as on 30-6-1948*; (ii) Reserve Bank of India, *Report on the Survey of India's Foreign Liability and Assets as on 31-12-1955*, 18; (iii) 'Foreign investments in India: 1957 and 1958', *RBI Bulletin* (June 1959) 660-1; (iv) 'Foreign investments in India: 1959 and 1960 (Preliminary trends)' *RBI Bulletin* (May 1961) 676; (v) 'Foreign investments in India: 1960 and 1961 (Preliminary trends)' *RBI Bulletin* (October 1962) 1532-3.

foreign capital and the outflow of investment income and repatriation is quite substantial, the adverse balance varying between Rs. 26 crores and Rs. 45 crores annually during 1948-59. The negative balance was Rs. 26.7 crores annually during July 1948-December 1953. It was larger during 1954 and 1955, the adverse balance being Rs. 37.8 crores annually. The adverse balances were lower in 1956 and 1957 amounting to a total of Rs. 30.4 crores and Rs. 28.8 crores respectively. However, the balance showed a considerable adverse trend in 1958 and 1959 to the tune of Rs. 45 crores and Rs. 34.8 crores.

Even if we take into consideration the private foreign capital inflow in the form of investments in kind also, the position does not change materially. The net results on our balance of payments on account of foreign capital inflows and outflows showed an adverse balance varying between Rs. 11 crores and Rs. 33 crores annually during 1948-59. It was Rs. 11.6 crores annually during 1948-53 and Rs. 31.4 crores during 1954 and 1955. The adverse balance stood at a lower figure of Rs. 21.9 crores in 1956 and Rs. 17.4 crores in 1957. But there was a deterioration in the position in 1958 and 1959, the adverse balance amounting to Rs. 32.7 crores and Rs. 27.3 crores respectively. The positive balance of Rs. 13.4 crores in 1960 was due to the unusually high level of investments in kind, mainly in the petroleum sector. There is every reason to think that this indicates an abnormal phenomenon in one year rather than the beginning of a new trend.

Capital inflow and outpayments for service charges and repatriation are, obviously, not the only factors affecting a country's balance of payments position or its capitity to meet the servicing of foreign obligations. The attempt to assess the effects of only a few items in the balance of payments, namely, those relating to the capital account, may seem to be an unnecessary attempt at partial analysis. With the same reasoning, one may dismiss the attempt to calculate the net effect on foreign exchange resources resulting from the operation of foreign companies either through export promotion or import replacement.

It is true that, for the external payments position of a country to be safe, all that is needed is to have an overall equilibrium and not necessarily a definite relation between capital inflow and outflow of resources for investment income and amortization payments. The basic problem is how the economy as a whole, with the interplay of its internal and external elements, can maintain the external payments position without strain.

According to the data published by the Reserve Bank of India, foreign controlled companies in India contribute about 30 per cent of the total exports of India. The share of the foreign sector in the export of various commodities in 1956 and 1957 can be gauged from the following table:

Table 53

SHARE OF FOREIGN-CONTROLLED COMPANIES IN INDIA'S EXPORTS, 1956 AND 1957

(Rs. crores)

Commodity	*1956* Total (private) exports of India	*1956* Exports of foreign controlled companies	*1956* Percentage of (3) to (2)	*1957* Total (private) exports to India	*1957* Exports of foreign controlled companies	*1957* Percentage of (6) to (5)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Tea	139.4	101.6	72.9	129.7	90.9	70.1
Tobacco	16.4	7.3	44.4	12.8	5.1	39.8
Cashew kernals	15.9	2.2	14.1	14.1	1.8	13.0
Metallic ores	37.4	5.3	14.1	45.2	7.6	16.8
Vegetable oils	29.2	3.8	12.9	16.5	1.5	9.1
Cotton raw & waste	28.9	5.0	17.3	20.2	4.3	21.1
Cotton yarns & manufactures	77.7	5.0	6.4	82.3	5.5	6.7
Jute yarns & manufactures	122.1	35.8	29.3	125.2	34.3	27.4
Hides & skins tanned	23.8	4.5	18.8	23.6	5.0	21.4
Others	169.8	29.9	51.7	181.6	28.3	48.2
Total	660.6	200.4	30.3	646.1	184.3	28.5

Source: *RBI Bulletin* (January, 1959) 18.

As can be seen from the above figures, the contribution of foreign-controlled companies in India to our exports is substantial. The conclusion about the adverse effects of foreign capital on balance of payments reached earlier, on the basis of capital inflows and outflows only, it seems, have to be qualified in the light of these figures. However, no definitive conclusion is possible unless we have similar figures regarding the import content of these companies. Available information indicate a tentative conclusion that the net contribution to balance of payments, taking into account exports, import content, and capial flows, may not be substantial in many fields, and possibly negative in many other fields.

The tendency of investment income payments to outstrip fresh capital inflows and the possibility that this defect may not always be corrected through export promotion and import substitution introduces a basic difficulty for the recipient countries to honour their obligations. It seems that there is a fundamental defect in the nature of capital accumulation with foreign resources which makes their repayment difficult in the long run. There is a sufficiently strong case to argue that foreign capital itself undermines the ability of the recipient country to service the obligations and thereby cause their large scale defaults.

There is a popular belief among professional economists as well as lay men that, in the matter of servicing foreign debt, there exists a self-operating mechanism.[12] In support of this contention economists often point out the tendency of private foreign capital to enter those fields of business activity which increase the recipient country's exports or reduce her dependence on imports. In India this tendency was clearly visible in the colonial period. In recent history too, the export sector has continued to maintain the important position as a sector which attracts foreign investments, even though, in relative terms, it has lost ground to

12. This idea has been lingering in the minds of many public men in India. For instance, this belief was expressed by T. T. Krishnamachari in one of his speeches in the Constituent Assembly.—*Constituent Assembly of India (Legislative) Debates,* IV, 1 (6 April 1949) 2419.

manufacturing industries catering essentially to the domestic market.

Table 54

FOREIGN PRIVATE INVESTMENTS IN INDIA

(Rs. crores)

	As at the end of							
Sectors	*1948*	*1953*	*1955*	*1956*	*1957*	*1958*	*1959*	*1960*
1. Trading & plantations	95.2	99.2	114.3	117.2	114.0	126.0	123.4	129.7
2. Petroleum	22.3	77.1	104.0	116.4	134.1	118.4	119.5	149.2
3. Manufacturing	70.7	124.1	129.1	132.8	137.1	146.4	165.3	184.3
4. Others	67.6	91.6	106.0	111.8	110.9	109.6	103.3	103.2
Total	255.8	392.0	453.4	478.2	496.1	500.4	511.5	566.4

Sources: (i) Reserve Bank of India, *Report on the Survey of India's Foreign Liabilities and Assets as on* 31-12-1955; (ii) 'Foreign investments in India: 1957 and 1958', *RBI Bulletin* (June, 1959); (iii) 'Foreign investments in India: 1959 and 1960, (Preliminary trends, *RBI Bulletin* (May, 1961), (iv) *RBI Bulletin* (October, 1962).

Note: 'Petroleum' includes both trading and manufacturing.

Out of Rs. 255.8 crores of private foreign investments in India at the end of June 1948, Rs. 95.2 crores or 37 per cent of the total were in trading and plantations. The percentage share of these sectors was 25 per cent in 1953 and 1955. Even though there was a slight reduction in the percentage share since 1956 (24 per cent in 1956, 21 per cent in 1957, 22 per cent in 1958 and 20 per cent in 1959), the absolute volume of private foreign investments in these two sectors stood at about Rs. 130 crores out of a total of Rs. 566 crores of foreign investments in India in 1960. The average share of trading and plantations during 1948-60 works out to be about 25 per cent. Against the decline in the percentage share of 'trading and plantations', since 1956, we should take into account the fact that under 'Petroleum' are included large investments of foreign capital in petroleum trading. The general conclusion that the export sector continues to be an important sector for private foreign investments can, therefore, be sustained with sufficient force.

Many economists have tried to justify the flow of foreign capital into the export sector on the ground that it would help the recipient country to minimise her balance of payments difficulties or strengthen the payments position.[13] The proposition that foreign investments should be directed towards those sectors which help to increase the country's exports or decrease its imports should not, however, be applied in a rigid manner. The process of economic change that results from the investment of foreign capital in different sectors of the economy is not so simple as to warrant such an easy solution. The assumption that the investment of foreign capital in the export-import sector will automatically strengthen the payments position of a country is, no doubt, based on inadequate analysis and economic reasoning. It is possible that, along with the channellisation of foreign investments to the export-import sector, complementary domestic investments will take place which may adversely affect the balance of payments. When domestic invesment is induced by foreign capital in related or complementary industires, it may either increase the volume of imports or result in the domestic absorption of export goods. If it happens, the favourable effect of the investment of foreign capital in the export-import sector will be minimised or nullified. It follows that the channellisation of foreign finance to the trade sector can be accepted as a solution to the balance of payments problem only if we assume the absence of negative repercussions in the domestic sector.

The above argument can be extended further by introducing positive or favourable repercussions in the domestic sector. It is possible that the investment of foreign capital in a non-trade sector may induce domestic investment in sectors which promote exports or replace imports. Export

13. J. J. Polak, for example, has argued for the maximisation of investment in industries producing goods (services) for export or replacing goods (services) hitherto imported and minimising investment in sectors producing goods (services) for domestic requirements (J. J. Polak, 'Balance of payments problem of countries reconstructing with the help of foreign loans', *Quarterly Journal of Economics*, 1943, 208 ff.).

promotion may be either due to domestic investment in a newly discovered exportable commodity or due to the conversion of domestic goods into export goods through comparative cost changes. The major factor in export promotion through comparative cost changes in the domestic sector relates to external economies. For example, foreign investments in railways may reduce transportation costs to such an extent that certain commodities which are at present domestically consumed may be supplied at a comparatively low cost, thus, entering the export market.

In the Indian context, even though the trade sector is quite substantial, the predominance of other sectors suggests that the 'self-operating mechanism' does not readily work. This is particularly true of manufacturing industries, most of which cater for the domestic market. In this case, the transfer abroad of profits and dividends is not facilitated by an increase in exports. Again, most of these manufacturing operations are dependent upon the import of machinery, intermediate products and raw materials from abroad, thus, raising the level of imports.

The difficulties arising from such a combination of adverse factors would be eased if foreign investments are made in import-substituting manufactured goods. However, the possibilities of such substitution are very often cancelled by the fact that a portion of the domestic raw materials which were previously exported may be absorbed by the foreign-owned factories in the country. Further, the expansion in aggregate domestic income as a result of investment expenditures during the period of deliberate industrialisation tends to increase the demand for foreign products, thus, aggravating still further the difficulties in the balance of payments.

No doubt, from the point of view of the Indian economy as a whole, it is not entirely necessary that industries in the foreign sector should have a favourable effect on the balance of payments. Theoretically, it is enough if all the industries, both in the domestic and foreign sectors taken together, have a favourable effect on the balance of payments. In a very general sense, the pace of economic development in

the country determines the capacity of the country to meet the repayment problem.[14]

No doubt, a mechanical application of a policy of directing foreign capital into the export-import sector should be avoided. But it will be wrong to conclude that, since both the foreign and domestic sectors can promote exports and reduce imports, it is not necessary to insist on the foreign sector to strengthen the balance of payments. It should be remembered that, in the context of a developing economy, a major rationale for welcoming foreign capital is its possible contribution to foreign exchange resources. If this external aspect of developmental finance cannot really be attributed to foreign capital, then the case for foreign capital will be largely demolished. The effect of foreign capital on the recipient country's balance of payments should, therefore, be taken as an important criterion for giving entry and authorisation to foreign capital. While adhering to this general policy, attempts should be made to assess the overall position in the foreign and domestic sectors. Only after such an overall assessment of the impact of the entire economy on the balance of payments can a rational foreign investment policy with operational validity be evolved.

A suggestion has been advanced by many economists that India can keep the ball rolling by further receipt of foreign capital or further borrowings from abroad on governmental account in order to pay the investment income charge and to meet repayment obligations:

> The game can continue to be played as long as new loans cloak the difficuly. But this is only another way of saying that debtors need never default as long as creditors are willing to advance them new loans to meet maturing obligations.[15]

It should be remembered that there is danger inherent in

14. This general belief in the capacity of a developing economy to meet its repayment obligations was expressed by the Reserve Bank of India (with reference to India's repayment problem) in their *Report on the Survey of India's Foreign Liabilities and Assets as on 31 December* 1953, 73.

15. N. S. Buchanan, *International Investment and Domestic Welfare* (New York, 1945) 116.

a policy of perpetuating the debts by further debts. India cannot bear the high cost of service payments for an indefinite period without putting downward pressure on domestic consumption levels and slowing down of the investment effort within the domestic ecnomy. Moreover, the assumption that a steady inflow of foreign capital will be forthcoming indefinitely is rather naive. In the case of private foreign capital, it is more likely that the investment opportunities for such investments will tend to be less and less as development proceeds in the recipient country. This is because private foreign investors would enter sectors where the investment yields are relatively higher, and as time passes, the investment opportunites in the country will appear less and less attractive.

Even if we assume that foreign capital of the desired magnitude will be forthcoming for a considerable period of time in the future, it does not follow that the new loans can be utilised to pay for the investment income charges of private foreign capital and for the interests and amortization of past loans. It is possible that loans will be contracted for specific industrial and developmental projects with specifications for the utilisation of the loans. In the absence of complete discretion in their utilisation, fresh inflow of foreign finance may not suffice to solve the problem of servicing foreign obligations on past loans even in the short run. The failure of even an increasing rate of capital inflow to ward off an adverse payments position due to the cumulative character of investment income payments has already been demonstrated in earlier pages.

In the ultimate analysis the solution to the problem of servicing foreign obligations lies in the considerable improvement of the country's foreign trade account through export promotion and import replacement. This implies that the policy of a recipient country towards foreign capital investments should be based on a 'selective approach' which discriminates against those foreign investments which adversely affect the country's balance of payments position. No 'blank cheque' can be given in the matter of entry and authorisation of foreign capital.

Chapter VIII

Role of Foreign Capital

THE role of foreign capital in India since independence has to be assessed in relation to the declared social objectives of the country. Is it true that external resources mobilised by the government from private and public sources abroad since independence have worked in the direction of strengthening our economic independence? Is it true that foreign capital resources have reinforced those sectors and forces in the economy which were accepted by us as the strategic elements in economic growth under the five year plans? And, has external finance helped us in moving towards the declared goal of a socialist pattern of society?

If the answers to the above questions are in the negative, the overall impact of foreign capital has to be adjudged as negative, notwithstanding the positive contributions of foreign capital in certain particular sectors or in certain specific respects. The net benefits which the Indian economy may acquire from foreign capital in particular sectors should not, in other words, override broader considerations of national importance.

The significance of an overall assessment of the role of foreign capital as indicated above is often lost sight of in the elaborate micro-economic analysis of the contributions of foreign firms to capital formation, income and employment. If we abstract from the cost involved in the investment of foreign capital in India in terms of its effect on economic concentration and monopoly trends in India, and the pressures on the Indian economy for moving away from its declared objectives, it is possible to arrive at quantitative measurements of benefits of foreign capital. For instance,

one could calculate the percentage contribution of private foreign firms to total capital formation in the private business sector in India. Similarly, the contribution of the foreign sector to income and output, employment, etc., may be worked out in quantitative terms. But it should be remembered that all these attempts at partial analysis do not enable us to arrive at a quantified measure of the net benefits or net costs to the Indian economy, emanating from the foreign sector. Any assessment of the role of foreign capital has to be based on an analysis of the impact of foreign capital in terms not only of its micro-economic aspects, but also, and more significantly, of its relevance to the overall direction and strategy of Indian economic development and the attainment of India's declared social objectives.

The above point may be illustrated with reference to the impact of foreign investments on capital formation, output and employment in India. If we isolate the contribution of foreign firms to capital formation in India, and evaluate it separately from other factors we will be tempted to conclude that the benefits are larger the larger the share of foreign capital in total capital formation in the business sector in India. Similar arguments can be advanced in respect of the share of foreign firms in total output and employment in India.

The import of foreign capital has a direct impact on income and output in the Indian economy. The foreign companies in India distribute large amounts of money to the various factors of production in India which will have an effect on the level of economic activity in India. The disbursements of wages to workers and other employees, the payments to the Central and State governments in the form of taxes, the local payments of the firms for the purchase of raw materials, intermediate goods, machinery, etc., and other disbursements of the firms in India do contribute in a general way to the degree of economic intercourse and consequent prosperity of the country.

The role played by foreign firms in income expansion in India is not limited to the income arising out of their direct payments. In addition to the considerable volume of local

direct payments, the foreign firms stimulate in an indirect way, the income expansion in a number of subsidiary related lines. Firstly, the direct payments by the firms will stimulate business activity as the recipients of this direct income will either invest part of the sum in productive channels or spend the amount for the purchase of consumer goods. The increase in the demand for real resources will stimulate production in other sectors of the economy. Secondly, the operation of the foreign firms will stimulate the production of a number of goods in auxilliary and related lines.

The income expansion caused by foreign capital investment is, in certain causes, neutralised by a negative change in domestic investments. A genuine case where foreign capital import does not lead to any increase in capital formation and income and output expansion is when a foreign investor simply purchases the interests of an already functioning domestic industry without making any addition to capital stock in the industry. The contribution would be nil if. (a) the domestic investor who sells out his interests spends the entire amount for conspicuous consumption or for hoarding and (b) the changeover of ownership and management leads to a decrease in efficiency and output.

Investment is not only income-creating, but also employment-creating.[1] The investment of foreign capital will have a definite relation to the level of employment in India. To what extent employment will be stimulated by the investment of foreign capital in an industry depends, of course, upon the nature of the industrial operation undertaken. The impact of foreign investments on the employment situation covers, generally, two categories, (i) the enlargement of

1. Dealing with the role of foreign capital in the industrial development in India and the benefits accruing to the national economy as a result of foreign capital participation in industrial ventures, the Minister of Commerce and Industry stated in Parliament that 'Indian capital will have to be supplemented by foreign capital provided we want rapid progress.... when an industrial undertaking is set up in the country the major benefits to the economy of the country arise on account of the employment it provides and the production which it makes possible'.—See the statement of the Minister of Commerce and Industry during the debate on Demands for Grants in Parliament on 4 April 1953, *Parliamentary Debates (House of the People)* III, 5, 3660-1.

the volume of employment, and (ii) the diversification of employment. To assess the total impact we have to take into consideration the repercussions on the employment situation on account of both these categories. Again, the volume of employment may be affected in two ways: (i) utilisation of labour resources previously unemployed, and (ii) diverting currently employed labour force from domestic sector to the foreign sector. If the currently employed labour force in the domestic sector is only partially employed or underemployed, the diversion of that labour force to full-time operations in the foreign sector would mean a diminution in disguised unemployment, even though this may not be reflected in the usual employment statistics.

As pointed out earlier, the contributions of foreign firms to capital formation, output and employment do not give us sufficient index of the role of foreign capital in the Indian economy. In terms of the broader economic and social objectives in India, it is fairly obvious that larger the share of foreign firms in the total capital invested in the business sector in India, the greater is the cost to the economy. Foreign control over business activity in India and concentration of economic power in the hands of foreigners have an adverse impact on India's economic independence.

For determining the role played by foreign companies in the provision of capital resources, we shall first of all make an estimate of the share of foreign companies and branches in the total capital resources of all companies working in India.

At the end of 1948 there were 22,674 joint-stock companies in India with Rs. 569.56 crores of paid-up capital. The increase in paid-up capital of all companies during the period 31 March 1948 to 31 March 1953 was Rs. 338.01 crores, thus reaching a total figure of Rs. 897.57 crores.[2] By 1958 the figure stood at Rs. 1,155 crores. In other words, the total paid-up capital of all joint-stock companies in India almost doubled itself during a period of ten years between 1948 and 1959.

2. Government of India, *India, 1949,* Statistical abstract.

Now it will be interesting to juxtapose the volume of foreign capital in joint-stock companies in India in all these years against the volume of total capital in all the joint-stock companies in India. The proportion of foreign capital in private business to the total capital in Indian industries will give us a rough picture of the share of foreign companies in the total capital formation in India in the private sector.

Table 55

SHARE OF THE PRIVATE FOREIGN SECTOR IN THE TOTAL CAPITAL EMPLOYED IN THE ORGANISED PRIVATE SECTOR IN INDIA

(Rs. crores)

Years	*Total paid-up capital in private companies incorporated in India*	*Capital invested in branches of companies incorporated abroad*	*Total private institutes in the organised private sector in India (2)+(3)*	*Total private foreign capital in India*	*Percentage of (5) to (4)*
1	2	3	4	5	6
1948	569.6	145.8	715.4	255.8	35.8
1953	897.6	220.7	1118.3	392.0	35.1
1955	969.6	253.9	1223.5	453.4	37.1
1957	1,005.0	251.2	1256.2	496.1	39.5
1960	1,124.7*	275.8	1400.5	566.4	40.4

Sources: (i) *RBI Bulletin* (June, 1959) 669; (ii) *Ibid.*, October, 1962, 1531; (iii) Raj K. Nigam and N. C. Chaudhuri, *The Corporate Sector in India* (New Delhi, 1960).
*Provisional.

Among individual industries, tea plantations, matches, soap, and paints and varnishes accounted for substantial share of foreign capital in the total foreign capital investment. About 60 per cent of the total capital invested in the soap industry and the match industry are contributed by foreign private investors. In the tea planting industry, the share of foreign investors is still greater, standing at about 68 per cent. The following table (Table 56) shows the share of non-Indian investors in capital formation in certain selected industries in India.

Table 56

SHARE OF FOREIGN PRIVATE CAPITAL IN THE TOTAL CAPITAL INVESTMENTS IN CERTAIN INDUSTRIES IN INDIA, 1956

(Rs. lakhs)

Industries	*Total productive capital in the industry*	*Foreign capital in the industry*	*Percentage of (3) to (2)*
(1)	(2)	(3)	(4)
1. Cement	46,73	1,05	2.25
2. General engineering and electrical engineering	97,63	2,75	2.82
3. Food products including vegetable oils	48,39	3,22	6.65
4. Chemicals	80,63	1,04	1.29
5. Iron and steel	94,02	9,43	10.03
6. Jute and coir goods	83,35	13,03	15.63
7. Matches	3,79	2,29	60.42
8. Paints and varnishes	5,35	2,04	38.11
9. Soap	9,28	5,60	60.34
10. Tea plantations	126,77	86,26	68.05

Sources: (i) *Eleventh census of Indian manufactures* (1956) xxi-xxxii; (ii) Reserve Bank of India, *Report on the Survey of India's Foreign Liabilities and Assets as on* 31-12-1955, Statistical app. Statement 8, x-xii.

In assessing the role played by foreign firms in the matter of employment, an important index that we have to employ is the progress of Indianisation that has been achieved in the foreign firms.

An analysis of the available statistics regarding the employment of Indians and non-Indians in foreign controlled business enterprises shows that the progress of Indianisation so far is far from satisfactory. For a proper assessment, we have to look into (i) the total employment position of Indian and non-Indians, and (ii) the distribution of the employment in various salary groups.

In terms of total employment in all salary groups, the position showed a definite improvement after 1947. Employment of Indians increased from 6,162 in 1947 to 21,242 in

1955, i.e., an increase of about 250 per cent. On the other hand the number of non-Indians employed in foreign enterprises in India showed a slight increase from 7,623 in 1947 to 8,270 in 1951, but again declined to 7,526 in 1955. Compared to the position in 1947 the employment of non-Indians in 1955 was almost stationary.

The progress in Indianisation as revealed by the figures for total employment in foreign enterprises, however, conceal another significant fact. Even though the total employment of Indians has increased considerably in comparison to non-Indians, the increase in the number of Indians employed is largely concentrated only in the salary groups Rs. 500-999. In this salary group, the process of Indianisation of jobs was done through a reduction in non-Indian personnel and absorbing Indians in their place. But in the salary group Rs. 1000 and above, consisting of practically all the key jobs, both technical and managerial, even though the number of Indian personnel has shown a continuous increase, the strength of foreign personnel has remained almost unchanged.

Table 57

EMPLOYMENT IN HIGHER SALARY GROUPS IN FOREIGN CONTROLLED FIRMS

Years	*Rs. 500-999*		*Rs. 1000 and above*	
	Indians	*Non-Indians*	*Indians*	*Non-Indians*
1947	2225	1616	504	5844
1950	4238	1299	1406	6871
1952	6557	1033	2290	7104
1953	7496	650	3346	7008
1955	8169	548	3995	6810

The above table shows that, in general, the increase in Indian personnel in the higher salary groups was effected through the absorption of Indians in newly created employment channels and not through the replacement of non-Indians. It also reveals the rigidity in the foreign investors' approach to the question of Indianisation of managerial and technical jobs in the high salary groups. '...in the past ten years, far more Indians have moved into middle-executive

and scientific positions in foreign firms, while the number of foreign personnel in top positions has remained roughly constant'.[3] While the foreign firms are prepared to replace non-Indians with Indians in lower salary groups, they are adamant to any programme which involves the replacement of their non-Indian personnel in key jobs of managerial and technical nature.

The sectors where non-Indians occupy more than two thirds of the employment in the higher salary groups of Rs. 1000 and above are the plantations, jute-mill industry, banking, agents and merchants, and transit and Transport.

Of the total number of 7,623 non-Indians employed in foreign-controlled enterprises in India in 1947, the predominant national group was British with a total number of 6,901. The number of British nationals showed a slight decline to 6,747 by 1954 and to 6,462 by 1955. However, British personnel continue to maintain the large majority of salaried posts in the foreign-controlled companies in India.

Private foreign investments in India, particularly in the early years, showed a marked tendency to concentrate in the export-import sector. It is true that, in recent years, additional private foreign capital has gone largely into sectors catering to domestic demand. However, the private foreign sector still continues to have a substantial control over India's exports, as is evident from Table 58.

Three important factors are responsible for this development. Firstly, the foreign firms in India which are either subsidiaries of parent companies abroad or branches of companies incorporated abroad have intimate connections with export market. The world-wide trade connections of the parent companies are directly utilised to the advantage of the subsidiary companies and branch firms. The already established export outlets of the parent companies give a definite superior advantage to the foreign firms in India compared to the Indian firms. Secondly, the growth of monopoly power in the foreign sector and the organisation of

3. George Rosen, *American Trade with Asia and the Far East,* 130.

Table 58

SHARE OF FOREIGN-CONTROLLED COMPANIES IN INDIA'S EXPORTS, 1956 AND 1958

(Rs. crores)

Commodity	1956			1958		
	Total (private) exports of India	*Exports of foreign controlled companies*	*Percentage of (3) to (2)*	*Total (private) exports of India*	*Exports of foreign controlled companies*	*Percentage of (6) to (5)*
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Tea	139.42	101.64	72.9	134.74	87.11	64.7
Tobacco	16.36	7.26	44.4	16.97	6.67	39.3
Cashew kernels	15.94	2.24	14.1	14.19	0.98	6.9
Metalic ores	37.42	5.29	14.1	31.96	4.93	15.4
Vegetable oils	29.16	3.77	12.9	10.92	0.70	6.4
Cotton raw and waste	28.87	5.00	17.3	21.77	4.95	22.7
Cotton yarns & manufactures	77.68	4.95	6.4	62.26	5.55	8.9
Jute yarns & manufactures	122.11	35.82	29.3	105.74	33.64	31.8
Hides & skins tanned	23.84	4.49	18.8	18.33	3.47	18.9
Others	169.79	29.89	17.6	176.55	22.13	12.5
Total	660.59	200.35	30.3	586.38	170.13	29.0

Source: *RBI Bulletin* (January, 1959) 18, and (January, 1960) 14.

industrial and trade associations among foreign companies have further strengthened the power of foreign firms to keep off Indian industries from a considerable portion of India's export trade. Thirdly, the products in which foreign investors have come to specialise in India are mostly those which can command an increasing demand in the world market.

On the import side, again, the foreign-controlled companies have a substantial share of India's total imports on private account. The import trade in mineral oils is almost exclusively controlled by foreign firms. The share of these companies amount to 93 per cent of total private oil imports.

Foreign-controlled companies have also a substantial share in the imports of electrical goods, chemicals including drugs and medicines, machinery including vehicles, locomotives and spares, and metals including iron and steel.

Table 59

SHARE OF FOREIGN CONTROLLED COMPANIES IN INDIA'S IMPORTS, 1956 AND 1958
(Rs. crores)

	1956			1958		
Commodity	*Total (private) import of India*	*Imports of foreign controlled companies*	*Percentage of (3) to (2)*	*Total (private) import of India*	*Imports of foreign controlled companies*	*Percentage of (6) to (5)*
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Food, drink & tobacco	37.49	4.93	13.2	19.79	2.30	11.6
Mineral oils	86.35	81.29	94.1	88.01	81.82	93.0
Cotton raw & waste	57.75	5.17	9.0	23.06	2.76	12.0
Chemicals (including drugs and medicines and dyes and colours)	57.03	26.21	46.0	47.99	18.50	38.5
Cutlery & hardware	27.51	4.16	15.1	11.02	1.81	16.4
Electrical goods	23.34	12.24	52.4	16.67	9.66	57.9
Machinery (including vehicles and locomotives)	190.64	40.88	21.4	146.45	35.28	24.1
Metals (including iron & steel)	148.41	14.69	9.9	69.28	11.61	16.8
Others	161.23	20.94	13.0	135.65	19.04	14.0
Total	789.75	210.51	26.7	557.92	182.78	32.8

Source: *RBI Bulletin* (January, 1960) 15.

If we take the period 1951-58 there was decline in the relative share of foreign companies in India's exports from 39.8 per cent in 1951 to 29 per cent in 1958. In the case of imports, on the other hand, the share of non-Indian interests increased from 25.7 per cent in 1951 to 32.8 per cent in 1958. Despite these changes, foreign concerns continue to

have substantial control over India's foreign trade. It is important to remember in this connection that the substantial control of foreign-controlled companies on India's foreign trade is, by and large, a reflection of control which these companies exercise over industry and banking in India.

An analysis of the structure of private foreign business investments in India reveals an interesting phenomenon, namely, the increasing preference of foreign investors for direct control over the industries in which they invest. There is a marked preference for effective control over the companies or firms in which foreign capital participates. This is clearly reflected in the shrinking significance of portfolio investments.

Direct foreign investments involve a greater cost to the Indian economy because they are accompanied by foreign control over our economic structure. In this respect, it is preferable to encourage the inflow of portfolio capital. Since foreign loans are not accompanied by direct control over the industry, there is no danger of foreign investors acquiring undue influence on the Indian economy. Yuan-Li Wu has tried to contradict this argument by saying that

> ...this view seems to overlook the fact that even if all international investment took the form of such loans; the bond-holders would still be able to exert political and economic pressure on the debtor Government and individual borrowers, or indirectly through the intervention of the investors' own Government. This danger is enhanced if the investors are large power groups such as banking consortium or other forms of private monopoly.[4]

Nobody would dispute the possibility that foreign investments in the form of foreign loans may have certain compulsions on the business policy of the domestic enterprises or on the economic policy of the recipient country. But it is an undisputed fact that compared to portfolio capital, direct foreign investments involve greater foreign control over the economy of the recipient country and consequent pressure on the economic policy of the country.

4. Yuan-Li Wu, 'International Capital Movement and the Development of Poor Countries', *Economic Journal*, LVI (March, 1946), 91.

> Indian economic history is replete with instances where foreign capital has used its influences to twist the course of economic and political development and tried to use its influence with that political power which assured it a favoured position.[5]

If we study the role of direct investments in the historical setting of Asia and other underdeveloped areas, we will come to the irrefutable conclusion that the preponderance of direct foreign investments and colonial status in the economic field was enforced upon these countries. Direct foreign investment and colonial status have been mutually correlative. No wonder that direct foreign investments are looked upon by many as the 'badges of inferiority'.

The history of foreign investments in India is closely interwoven with the growth of monopoly capitalism. The concentration of control over an industry in the hands of a comparatively limited number of foreign companies has been particularly true in the case of British investments in India. This process of concentration has been further strengthened by the peculiar system of managerial control of the industries through the managing agency system.

The monopolistic element involved in foreign investments raises three important questions relating to the cost incurred by a recipient country. Firstly, in sectors where foreign investors gain a monopolistic or oligopolistic position, the cost of the investment to the recipient country in terms of the exported monopoly profits tends to be high. This follows from the fact that the monopolistic or oligopolistic element in business raises the profit much above the 'normal profit' which would occur under more competitive conditions. In other words, the existence of monopoly increases the cost which a recipient country has to bear on account of higher transfers of investment income. Secondly, the operation of monopoly tends to diminish the volume of product which would be forthcoming under competitive conditions. In other words, the benefits to the recipient country in terms of real domestic product (direct and indirect) will

5. D. T. Lakdawala, *International Aspects of Indian Economic Development* (Bombay, 1951) 41.

be less. On the other hand, the presence of foreign monopoly increases the cost to the Indian economy in terms of higher transfers of investment income. On the other hand, it reduces the benefits in terms of real domestic output. Thirdly, monopolistic competition from the foreign sector has destructive effects on indigenous industries leading to the replacement of domestic concerns.

It is true that the cost involved in monopolistic competition is nothing special to foreign capital. But in an economy in which domestic investors have a general disadvantage in terms of capital resources and technical and managerial skill, the creation of a foreign sector with superior resources and skill poses special problems of immense magnitude. The problem assumes its seriousness when we realise that the foreign companies which are engaged in business enterprise in the developing countries are generally giant companies exercising high degree of monopoly in their respective home countries.

A study of the United States corporations doing foreign business shows that practically the entire United Sates investments in foreign countries are owned by a comparatively few United States corporations. An analysis of American foreign investments shows that the 'likelihood of a company investing abroad increases according to its size'.[6] Only about 2 per cent of all manufacturing companies in the United States have foreign investments. But if we take the 1,000 largest companies in the United States, it will be seen that 52 per cent of these companies are foreign investors. About 84 per cent of the companies with assets of over 50 million dollars are engaged in foreign investment. The same phenomenon is true in the case of British companies operating in foreign countries.

It is argued that the superior competitive power of foreign concerns reflects superior technical efficiency and that the benefits of efficiency are actually diffused into the domestic sector as well. But it should be remembered that the diffu-

6. E. R. Barlow and Ira T. Wender, *Foreign Investment and Taxation* (Englewood Cliffs, 1955) 142.

sion of efficiency by the foreign sector among the domestic industries is not sufficient to compensate for the cost incurred on account of monopoly competition.

Let us suppose there are two entrepreneurs in a particular sector of the economy of underdeveloped country A (India), entrepreneur X being an indigenous industrialist and entrepreneur Y being a foreigner belonging to country B, but doing business in country A. We assume that due to the shortage of capital the rate of interest is higher in the underdeveloped country while, on the other hand, the rate of interest is lower in the capital-abundant country B.

Under these conditions, it will be seen that when both X and Y have drawn up their optimum production plans, the indigenous entrepreneur has to keep a greater share of the marginal yield for the payment of interest than it is in the case of the foreign entrepreneur. If we further assume that the price of the same commodity produced by entrepreneur X and Y is the same, in order that X may continue to exist in the field, the marginal physical returns to investment in his unit must be higher than that in the unit owned by Y. But since the indigenous entrepreneur is handicapped by the shortage of capital, he is not in a position to reap the advantages of largescale production and thereby realise higher marginal physical returns to his investment.

It is true that the indigenous entrepreneur possesses certain distinct advantage over the foreign producer, as for instance, better knowledge about conditions in the domestic market. But this is offset by the greater advantage possessed by the foreign entrepreneur in terms of superior technical and industrial know-how, better methods of organisation and marketing.

A study of the growth of private foreign investments in India will reveal that the increase in foreign investments has been marked in sectors such as mineral oils, medicine and pharmaceutical goods, and cigarettes and tobacco. The monopolistic position of foreign investors is substantially strong in most of these sectors. The problem assumes greater seriousness when, as in most cases, foreign interests are

greater international concerns. The danger lies in the fact that the interests of the country may be subordinated to the interests of the foreign concern.[7]

The main reasons why foreign investors are in a position to offer superior competition to the indigenous industries and acquire monopolistic advantages may be listed. Firstly, these industries, to be successfully operated, have to resort to highly capitalistic and complex methods and processes of production. The indigenous industrialists with comparatively less capital resources are not in a position to offer effective competition to the foreign firms. Secondly, the superiority of the foreign investors in regard to capital resources is accompanied by their ability to mobilise superior managerial staff. Thirdly, they are in a position to have complete control over technical know-how in the sense that certain patents are not allowed to be acquired by the indigenous entrepreneurs. The pooling of patents among large monopolistic interests for the purpose of consolidating their power and sharing the world market is a well-established fact.[8] Fourthly, they are in a better position to encourage and sustain unnecessary and exaggerated product differentiation. Again, the foreign entrepreneurs have recourse to high-pressure marketing operations with the aid of even unethical advertising methods.

Further, the financial protection extended by parent companies abroad bestows upon subsidiary companies in India the capacity to offer cut-throat competition by operating as 'fighting' companies with methods such as price slashing, profit margin slashing, and also by offering deferred rebates. These subsidiary companies operate under the protection of their parents and therefore can afford to lose for a considerable period in order to gain substantially thereafter.

The replacement of domestic industries due to the monopolistic competition of foreign firms was particularly evident during the British period. The position in the post-indepen-

7. University of Amsterdam, Foundation for Economic Research, *Management of Direct Investment in Less Developed Countries* (Leiden, 1957) 66.

8. Yuan-Li Wu, n. 4, 91

dence period, especially in the late 1950's, has become more complex with the emergence of Indo-foreign collaboration and joint-ventures; but the old tendencies are still manifest.

Let us take the example of the Match industry. One of the most powerful foreign companies in India engaged in the production of matches is the Western India Match Company. It is a concern controlled by Swedish investors and with Swedish capital. The operation of the company expanded with a leap forward from 1928 onwards. There were only 4 factories under this company in 1928. But the number increased to 11 in 1951. Apart from the 11 factories, the company has acquired effective control in a number of Indian companies through the holding of a large proportion of their share capital. Another company called the Match Manufacturing Supply Company which is a subsidiary of the Western India Match Company has the control over the supply of Swedish and Germany machinery. This colossal control system which the Western India Match Company built up during a comparatively short time, and their superior competitive power forced a number of Indian factories to abandon their operations. During a span of 10 years, about 30 Indian match factories were closed down (including 17 factories in Bengal).

In the soap industry, the Lever Brothers stand head over shoulders among many infant industries run by Indian industrialists. The Lever Brothers are the most powerful and resourceful soap company in the world. The total capital resources of this giant company outstrips the capital of all the Indian soap companies taken together. This company has flourished on the benefits of protection and with its superior capital resources, it has been able to drive many Indian concerns to the wall.

Take the case of tea plantations in India. British domination over the production, manufacture, transport, export and sale of Indian tea is, in a sense, a unique phenomenon. There is probably no other commodity on which a particular country has obtained such a degree of control over both production and export. The organisation of the Manag-

ing Agency system further increased the grip of foreign monopoly on the tea industry in India. In 1945, British managing agencies controlled about 90 per cent of the tea industry in India. In 1956 over 75 per cent of the tea production in North India was under the control of 13 leading agency houses in Calcutta. Out of these, 7 companies controlled more than 50 per cent and 5 companies as much as 36 per cent of the production.[9]

If we study the operations of some of the powerful managing agency houses in the United Kingdom, it will be seen that tea industry in India is, by and large, controlled from London. Ten of the largest managing agency companies in the United Kingdom together manage about 120 Sterling tea companies in North India, Pakistan and Ceylon which supply about 30 per cent of the total tea requirements of the United Kingdom.[10]

Foreign control is visible not only in production, but also in distribution. About 50 per cent of the tea at the Calcutta auction in 1954 was purchased by 8 agency houses in Calcutta. And about 85 per cent of the retail distribution of tea in India is controlled by 2 leading firms.[11]

The international tea market has also come to be controlled, to a large extent, by British monopoly elements. A significant percentage of Indian tea is shipped to London for public auctions. London is today the greatest centre of tea trade and the monopolistic position which a few British concerns have acquired is astonishing. 'An outstanding feature of the London tea market is the remarkable degree in which the buying is now concentrated in the hands of a few powerful combinations—principally blenders and distributors of proprietary blends'.[12] The concentration of tea trade in London, where the bulk of world tea exports

9. *Report of the Plantation Enquiry Commission,* 1956, I-Tea, 23.

10. United Kingdom, Monopolies and Restrictive Practices Commission, *Report of the Supply of Tea,* 7.

11. N. 9, 24.

12. Great Britain, Imperial Economic Committee, ***Eighteenth Report : Tea*** (London, 1931) 22.

is either absorbed or re-exported, means that the 'world price' of tea is 'made in London'.[13]

The concern of the Indian industrialists at the increasing competition of foreign firms was expressed by the President of the Indian Merchants' Chamber in his address to the Chamber in October 1952.[14] He even suggested that in fields where Indian-owned industries have made reasonable progress, 'foreign capital should not be allowed to come in and to operate freely'.[15] The complaints of the Indian business community were reflected in a despatch of the Special Correspondent of *Commerce* which observed that

> ... some spokesmen of Indian industry have begun to take an alarmist view of the encroachment of foreign capital in what are called 'certain legitimate' indigenous enterprises. They even go to the extent of asking the Government of India to discourage the inflow of foreign capital into those industries where it will directly compete with well-established Indian business.[16]

The replacement of Indian industries by the monopolistic competition of the foreign concerns is, as we have already noted, a cost to the Indian economy. This is a category of cost which can be assessed (if not measured) through a study of the actual replacements that took place as a result of competition from foreign concerns. But there is another category of cost which is not amenable to even a rough calculation, the 'opportunity cost' incurred by the Indian economy, which is the volume of domestic product which domestic capital would have produced if foreign capital was not allowed to enter and monopolise the industrial sectors in India.

The role of the managing agency system in the growth of foreign monopoly power in India needs special mention. The origin of the managing agency system in India can

13. V. D. Wickizer, *Tea Under International Regulation*, 10.
14. Speech of Pranlal Devkaran Nanjee, President of the Indian Merchants' Chamber, at the quarterly meeting of the Chamber in October, 1952.—Quoted in 'Foreign capital', *Commerce*, 25 October 1952, 758.
15. *Commerce*, 25 October 1952, 758.
16. 'Role of foreign capital in India', *Commerce*, 29 November 1952, 996.

be traced back to the early days of British finance capital in India.[17] The large number of British subsidiary companies started in India began acquiring a managerial superstructure called the managing agency system. The development of the system was the result of increasing power concentration in the foreign industrial sector and the strengthening of foreign monopoly power. Secondly, the organisation of industries in far away countries meant a relative scarcity of managerial staff, and therefore, the system of managing agents was adopted as a solution to this managerial scarcity.[18] Established agency companies were entrusted with the power to manage the affairs of large numbers of companies in complementary industries, and in certain cases, in diverse industrial fields.

The adverse effects of foreign managerial concentration on the Indian economy flow from two channels:

(1) the concentration of economic power in a limited number of foreign entrepreneurs and the consequent monopoly element and the high cost to the Indian economy; and

(2) the decrease in the benefits to the Indian share-holders in the foreign-managed companies on account of the mismanagement of company affairs[19] to fit in with the pecuniary motives of the managing agents.

17. In a way, the evolution of the managing agency system contributed to the increased inflow of foreign private capital into India and other underdeveloped countries. See Allen and Donnithorne, *Western Enterprise in Indonesia and Malaya* (New York, 1957) 52.

18. The following statement of Allen and Donnithorne brings out this fact very clearly:

> The managing agency system is in essence a method of industrial and commercial organization designed to reduce the risks of foreign investment in countries where business expertise and managerial skill are scarce. It is based upon a division of function between the firm in the metropolitan country which owns the business properties and the firm which manages them in the colonial territories.... Thus the scarce managerial resources are mobilized in the services of numerous proprietary companies, and specialization in investment is combined with a co-operative use of the expertise available in the country of operation (*ibid.*, 52).

19. H. T. Parekh argues that the 'abuses associated with managing agency system such as corruption, mal-administration, misappropriation of funds, etc., are not peculiar to the system' and that 'the abuses arise from

In theory, the managing agents are entrusted with the duty of managing the affairs of the company on behalf of the shareholders and so long as the share-holders desire the agents to continue in office. But in practice, the share-holders have been pushed to the background as passive observers of whatever dictatorial decisions the managing agents might take to perpetuate their own self-interest.

In purely legal terms, the share-holders have always had the powers to remove the managing agents if they went against the will of the share-holders. In most cases, managing agents could be removed if a resolution was passed in the general body meeting of the company with three-fourth majority.[20] But the real problem for the share-holders has been how to muster so much of the voting power. The managing agents have been better masters of the game and they could manage to pick up a solid block of shares for themselves in order to invalidate (in practice) the legal provisions regarding the requisite majority vote. Moreover, for the individual share-holders scattered over the whole country, it was practically impossible to muster all their strength together in order to take any concerted move for the removal of the powerful managing agents.

At the end of June 1948, there were 334 companies in India under the control of managing agency companies.[21]

the personnel managing rather than from the system of managing agents' (H. T. Parekh, 'Changing pattern of company management', *Economic Weekly*, Bombay, 12 November 1955, 1331).

20. The 'possibility', in strict legal terms, to exercise control over the managing agents by the share-holders is often exaggerated by many. It is argued by some that the managing agencies in India in the past have been under the actual control of the share-holders. For example, E. D. Sheppard, Chairman of the Killick Industries Limited, addressing the eighth ordinary general meeting of the Company held in Bombay on the 25 November 1955, stated thus:

> The massive achievements of many Managing Agency Houses during the past many years are well known... and such Houses have always been subjected to the stern control of all the concerns they have promoted and managed as well as the consumers of the various products of their enterprise (Quoted in *Economic Weekly*, Bombay, 26 November 1955, 1409-10).

21. Reserve Bank of India, *Report of the Census of India's Foreign Liabilities and Assets*, 30 June 1948, 72-3.

Out of the total value of shares in these companies which amounted to Rs. 90 crores, the value of shares owned by the managing agents came to only Rs. 13 crores. At the end of 1953, 36 foreign-controlled managing agency companies managed about 232 joint-stock companies in India.[22] It is interesting to note that, out of the total capital resources of these companies amounting to Rs. 74.22 crores, the capital invested by the managing agents was only Rs. 12.52 crores or 16.9 per cent of the total capital resources.

The magnitude of capital invested in the Indian joint-stock companies by foreign managing agents do not reflect the position which they actually hold. What makes the foreign managing agents powerful in the industry is not the magnitude of their investments, but the degree of control which they exercise over the joint-stock companies under their management. It is a remarkable phenomenon that the foreign-controlled managing agency companies with the ownership of only a very small portion of the share capital are in a position to install effective control over the Indian companies.[23]

An important feature of the managing agency system as evolved in India has been the preponderance of British interests. About 88 per cent of the total capital invested in foreign-managed companies in India in 1953 belonged to British managing agencies.

The average holding of the British managing agency companies in the share capital of managed Indian joint-stock companies was only 15.6 per cent. But they were in a position to exert effective control over the companies under their management.

Most of the managing agency agreements provided for a very long tenure for the managing agents. Foreign managing agency companies with strong financial backing have been in a position to insert all sorts of favourable conditions

22. Reserve Bank of India, *Report of the Survey of India's Foreign Liabilities and Assets*, 31 December 1953, 29.

23. Taya Zinkin calls the managing agency system as 'the method by which a minimum number of men are enabled to control the maximum amount of capital'.—Taya Zinkin, *Foreign Capital in India* (New Delhi, 1951) 16.

Table 60

VALUE OF SHARES HELD BY THE MANAGING AGENCY COMPANIES CONTROLLED FROM ABROAD

Country	Distribution of ordinary shares of managed companies			
	30 June 1948		*31 December 1953*	
	Total value	*Share of managing agents*	*Total value*	*Share of managing agents*
United Kingdom	7563.7	1134.9 (86.6)	7079.0	1101.0 (87.9)
Malaya	531.6	171.3 (13.1)	342.0	150.0 (12.0)
Other countries	866.2	3.4 (0.03)	1.0	1.0 (0.01)
Total	8961.5	1309.6 (100.0)	7422.0	1252.0 (100.0)

Sources: Reserve Bank of India, *Report of the Census of India's Foreign Liabilities and Assets as on 30 June 1948*, 73, and *Report of the Survey of India's Foreign Liabilities and Assets as on 31 December 1953*, 30.

in the articles of association of the enterprises under their management. In addition to the provision for long tenures, the agreements, in most cases, put an exorbitantly high financial obligation for a company in case the share-holders decide to remove the managing agency. The compensation fixed by the managing agency agreements varied between 10 and 12 times the average annual income for the preceding three to five years. Such exorbitant claims for compensation cannot be met by the majority of companies. In many cases where managing agents forced the company to pay the compensation, the claims could be met only by self-liquidation of the company.

The exorbitantly high rate of remuneration which the foreign managing agents have charged on the returns of the companies have meant a high cost to the Indian eco-

nomy.[24] Higher the rate of remuneration for the managing agents, lower the dividends which the Indian share-holders would get.

The form of remuneration for the managing agents vary from place to place and from industry to industry. The three main forms of remuneration which have been prevalent in India are (a) commission on output[25], (b) commission on sale[26], and (c) commission on profits[27]. Besides these forms of remuneration, the foreign managing agents, in many instances, have extracted large amounts in the form of head-office allowances, commissions on purchases and sales of stores, machinery, intermediate products, raw materials, etc. Very often we come across managing agency agreements which stipulate that managing agents have the right to extract their commissions even in the event of no profits. For an enterprise running at a loss or with no profits, this is definitely a very heavy burden and an injustice to the share-holders of the company on whose behalf the managing agents are supposed to function.

The manner in which foreign managing agents have functioned in enterprises in India clearly shows that Indian share-holders in those enterprises were denied the benefits

24. Even the managing agency commission at the rate of 10 per cent of net profits (as at present under the Companies Act, 1956), will involve greater burden to the Indian economy than an excessive remuneration on the basis of fixed salaries not related to profit. In the percentage system, as the company develops, increases in earnings will be spilt over to the managing agents. On the other hand, if the remuneration is in terms of fixed salaries, as the earnings of the company increase, the burden of managing agency remuneration will decline.

25. This has led to a lot of malpractices since, in many industries, the managing agents, interested in reaping higher profits and commissions, have tried to increase the quantity of output without caring for the quality of the produce.

26. The new Company Law passed in 1956 (The Companies Act, 1956), prohibits managing agencies from taking commission on sales and purchases, and forms of remuneration such as office allowances. The Act, however, fixes the total managing agency remuneration on the basis of a percentage share in net profits not exceeding 11 per cent.

27. The Companies Act, 1956, has put ceiling on managing agency commission at 10 per cent of net profits.

of their investments.[28] This was aggravated by the fact that the share-holders or even the directors elected by them had no control over the policy and operation of the company. In many cases, the directors were subservient to the managing agents.[29] The managing agents, with their ownership of a small solid block of shares in the company, could manoeuvre things in such a way that only the directors of their choice were elected. In certain cases, the managing agents have relied upon the articles of association to strip the directors of all their powers. Even in the appointment of auditors the managing agents have the decisive voice, as a result of which misappropriation of company funds by the managing agents and other irregularities were covered up by the outright partiality of the auditors.

The interlocking of the finances of the various companies under their management also aggravated this situation. The financial resources of efficient firms were transferred either to bogus concerns or for speculative and non-industrial purposes, as a result of which the growth of many of the financially strong enterprises were thwarted. The interlocking of finances and the large volumes of interim investments were designed by the managing agents to acquire disproportionate control over a large number of companies.[30]

28. A study made by the Foundation for Economic Research, University of Amsterdam, states that

> It is especially in India that serious objections to this form of management have existed for years, not only because of the dependence of the Boards of Directors on these agencies, but also as a result of the fact that the latter were said to direct the plants with an eye on their own interests and consequently to receive a disproportionately large part of the profits (n. 7, 163).

29. It was in the background of these facts that the Companies Act, 1956, made a number of restrictions on the managing agencies. The Act has made the managing agents subservient to the Board of Directors and has reduced their representation in the Board as 'ex-officio' directors from three to two.

30. In order to check these abuses and to reduce undue inter-locking of companies, the Companies Act, 1956, prescribed that the maximum number of companies which a managing agency can manage should be 10 after August 1960. The government have also reserved to itself the right to abolish the managing agency system in particular fields after 1960, if found necessary.

It is important to note that most of the managing agencies operate without sufficient capital resources of their own. Out of 77 managing agency companies (Indian and foreign) in 1958, 52 had share capital below Rs. 10 lakhs each. At least a dozen companies had only a nominal share capital of less than Rs. 5,000 per company. Among the companies with share capital above Rs. 50 lakhs were Andrew Yule, Martin Burn, MacNeill & Barry and Greaves Cotton. But the higher share capital of these companies do not reflect entirely their managing agency functions. Many of these managing agency companies have other business and their higher share capital indicates partly this vertical extension of their activities. In fact, all the companies which are pure managing agencies have only nominal capital of their own.

Since 1946, and particularly since independence, the foreign managing agencies in India have undergone considerable change. Most of the managing agencies which were partnership concerns were turned into private and public limited companies. This was particularly true of old agency houses in Calcutta and Bombay. Examples are Martin Burn, Mcleod & Co., Duncan Brothers, Gillanders Arbuthnot & Co., Shaw Wallace & Co., MacNeill & Barry, Jardine Henderson, Kettlewell Bullen & Co., all in Calcutta, and Killick Industries of Bombay. In many cases the changeover was effected by the public sale of shares and debentures, thus liquidating part of the interests of the old partners (part of which, in turn, was repatriated abroad) while the partners retained the management of the companies in the role of salaried officials and managers.

It is true that after the enactment of the Companies Act in 1956, the number of managing agencies has shown a definite decline. In 1954-55, out of 9,126 public limited companies in India, 4,091, or about 45 per cent of the total number were managed by managing agents, both Indian and foreign. By 1962-3, out of 5,380 public limited companies working in India, only 1,217 or about 23 per cent of the total were under managing agencies.[31] In the case of private

31. R. K. Hazari, 'The managing agency system: A case for its abolition', *Economic Weekly*, Annual Number, February, 1964, 316.

limited companies also there was a substantial reduction in the number of companies managed by managing agents. The total number as well as the relative share of private limited companies under managing agency system, however, has not been very significant.

In the immediate post-independence period, there was a substantial increase in foreign investments in the managing agency firms. Between 1948 and 1953, such investments showed and increase of Rs. 11 crores[32] which was 'not by any means an insignificant amount in itself'.[33] However, from the second half of 1950's there has been a decline in the share of foreign investors in managing agencies in India.

In 1951 the total share capital of managing agency companies in India (taking both ordinary shares and preference shares into account) was Rs. 17.63 crores out of which the share of foreign investors amounted to only Rs. 2.57 crores or 14.6 per cent of the total. In 1958 the share capital of foreign investors was reduced to Rs. 1.79 crores. This was only 9 per cent of the total share capital of managing agency companies in India amounting to Rs. 19.87 crores.

The reason for the decline of foreign investments in the share capital of managing agencies was partly the restrictive policies followed by the government and the regulations under the Companies Act of 1956. However, it was in part, also due to the changing strategy of private foreign capital to enter the Indian economy more and more as joint-ventures through Indo-foreign collaborations.

In recent years, many of the foreign managing agency compaines have converted themselves into joint-ventures. Foreign names such as Martin Burn, MacNeil & Barry, Kilburn, Andrew Yule, Fobes Forbes & Campbell, Greaves Cotton, Kettlewell Bullen and W. H. Brady are Indo-foreign companies. Similarly, a number of well-known Indian managing agency companies are partly owned by foreign interests. This category includes Tata Hydro-Electric Agencies and Cement Agencies.

32. Reserve Bank of India, n. 22.
33. 'Foreign liabilities and assets', *Economic Weekly*, 26 November 1955, 1389.

The phenomenon of joint-ventures in managing agency activities is only a reflection of a general trend towards Indo-foreign collaboration in the private sector in India. In recent years, foreign private capital has shown a marked tendency to enter Indian manufacturing industries jointly with Indian concerns. Engineering and electrical goods, chemicals and automobile ancillary industries have witnessed the largest number of such collaboration agreements.

Table 61

FOREIGN COLLABORATION

	1956	*1957*	*1958*	*1959*	*1960*	*1961*
Total	17	24	109	172	390	402
1. Automobile ancillary industries	—	1	7	31	33	30
2. Electrical engineering industries	4	6	31	41	80	80
3. Chemical industries	4	5	10	22	62	46
4. Glass industries	—	—	3	1	5	5
5. Engineering industries	2	7	37	56	113	124
6. Non-engineering industries	—	2	15	15	58	80
7. Shipping industry	2	1	—	—	—	—
8. Textile industries	2	—	—	5	19	15
9. Cement industry	—	—	—	1	3	3
10. Sugar machinery industry	3	2	—	—	—	1
11. Food processing industry	—	—	3	—	6	—
12. Non-ferous metals	—	—	3	—	2	3
13. Paper	—	—	—	—	9	13
14. Fertilizers	—	—	—	—	—	2

Source: *The Journal of Industry and Trade* (August, 1961) 1289.

The increasing collaboration between Indian and foreign concerns cannot be considered as a relapse into the old type of colonialism. However, it is a trend which one should view with great concern; for, an unrestricted extension of indo-foreign link-ups will reinforce the intensification of monopoly and economic concentration with all its adverse consequences on the economic and political situation in India.

Many foreign companies are prepared to enter into minority share participation in Indian enterprises. The motive behind this is often to get sufficient control over enterprises in India without, at the same time, being accused of foreign control and exploitation.

> Some American companies have decided that the whole project is sounder if instead of organising a new subsidiary that is wholly owned by the parent corporation, a unit is formed in which participation is taken by capital already familiar with the area. Some companies carry this to the point of preferring to have a management contract, but only a minority ownership position, in order to offset the accusation of exploitation.[34]

From the pont of view of the foreign concerns, Indo-foreign collaboration reduces the risks involved in pioneering an enterprise, particularly amidst the apparent uncertainties of governmental policy and market conditions. A big Indian company which has already established profitable public relations with the various government departments and institutions is an effective buffer for a new foreign company, venturing out business in India. The following statement of George Rosen is, in this connection, quite revealing: 'In many cases it would be desirable to invest joinly with a reputable Indian firm that has dealt successfully with the government and to whom some of the burdens of operating in India can be shifted'.[35] While the foreign concerns consider their Indian partners as an insurance against possible risks 'to whom some of the burdens of operating in India can be shifted', a similar logic has motivated their Indian counterparts to go in for foreign collaboration.

Prior to 1947 Indian industrialists had, broadly speaking, only one choice, that is, to accept a secondary role in the link-up with British combines which had the British state power behind it. But Indian industrialists today can choose between various foreign capitalists and play between them in order to protect and further the interests of the Indian

34. Clarence B. Randall, *The Communist Challenge to American Business* (Boston, 1959) 43.
35. George Rosen, n. 3, 133.

bourgeoisie. Today, link-ups between Tata and Krauss-Maffei, and between Dalmia and Benz do not involve the same restrictive character of the link-ups between Indian and British concerns during the British period. The Indian bourgeoisie, supported by an independent state power, has today a wide choice and can play between foreign powers in the name of nonalignment.

The role of private foreign capital in India during the period since independence has been to facilitate the drift towards monopoly and concentration of economic power in the hands of the few.

Apart from the role of private foreign capital in relation to India's economic independence, there is a very significant aspect of the discussion, namely the relevance of private foreign capital to economic development according to plan priorities.

Private foreign capital, particularly of the direct equity type, has a general tendency to avoid sectors such as agriculture, public utilities and social overheads and to go into only lucrative industries. This. is not surprising because considerations such as profit incentives and export and import inventives are generally absent in the case of these sectors. Another reason why private capital is not attracted to these sectors is the fact that most of the projects in these sectors have comparatively long maturity, the waiting period being too much for private investors to bear.

There was a time when public utilities were carried out with the aid of foreign private capital, mainly of the portfolio category. But after the Great Depression, the role of portfolio investments by way of private bond issues was reduced to insignificance. Direct investments have marked a significant increase; but such investments often shy away from public utilities and social overheads. In the changed situation of today, therefore, we have to place greater reliance on loans and grants from foreign governments and international agencies in order to start and expand public utilities in India and other underdeveloped countries. The governments of the recipient countries, with the help of

foreign public sources, have to shoulder 'the burden of supplying the wherewithal for these basic prerequisites of development'.[36]

Even in the manufacturing sector, there may be a number of industries which are not attractive to foreign private capital. Even if the rate of profit in the recipient country is greater than the profit rate in the investing country, foreign private capital inflow may not take place due to the absence of the import or export incentives.

In India foreign private capital has exhibited these tendencies in no small measure. Referring to American collaboration in business ventures in India, Nathanial Knowles, Deputy Director, United States Bureau of Foreign Commerce, indicated at a press conference in New Delhi on 14 November 1958, that among the industries in which American investors are interested for joint ventures are fertilizers, air-conditioning equipment, industrial furnaces, ovens and hydrolic valves, packaged automatic boilers, die blocks, steel forging materials, handling equipment, and machinery for cans and metal containers.[37] These industries may be offering high yields to the investing companies; but from the point of view of India's long-term industrial development, some of these sectors have a relatively low order of priority in development planning. The following observation of Prof. Kalecki is significant in this connection: 'Direct investment frequently takes place in certain branches of the economy . . . which may not be in tune with a reasonable plan for development of the resources of a country. It will give to that development a one-sided twist.'[38]

The scarcity of international capital resources (scarcity in relation to total needs of the underdeveloped countries), demands that external resources should be diverted to sectors which have greater priority in the economic development programme of the recipient country and that these resources should be utilised with utmost prudence. From

36. Norman S. Buchanan and Howard S. Ellis, *Approaches to Economic Development* (New York, 1956) 347.
37. *Hindustan Times* (New Delhi) 15 November 1958.
38. *Indian Economic Review*, February 1955.

the point of view of the recipient countries also, it is desirable that external capital is made to flow into sectors of priority because it is in these sectors that the total benefit of foreign capital will be the maximum. From the point of view of the recipient country, it may also be desirable to ensure the effective utilisation of external resources by avoiding duplication and diverting external capital to those sectors of business activity where domestic capital, for one reason or the other, is not likely to enter.

In most of the studies on foreign capital one can discern an implied assertion that the total quantum of foreign capital is an adequate index of the role played by it in the economy of the recipient country. It is easy to see that even though the volume of foreign capital or its share in domestic availability of funds may be of significance, it is not always an adequate index of its role in the domestic economy.

In a recipient country the proportion of foreign capital to domestic capital may be very insignificant, but the foreign investments may be in sectors of strategic importance. The investment of foreign capital in a few basic and strategic industries may be of greater value to the economic development of a country than the investment of a large volume of capital in a number of comparatively unimportant industries. Therefore, when we consider the role played by foreign capital we should take into account not only the quantum of foreign capital, and its proportion to domestic capital, but also the functional quality of the investments or the strategic importance of such investments.

The total volume of aid and the number of enterprises built with such aid do not provide adequate criteria for judging the contribution of aid to the Indian economy. Aid from the capitalist countries forms a major portion of the total aid received by India. But most of it has been dispersed over a large number of relatively low priority projects. On the other hand, aid from the socialist countries strengthen the productive forces of the Indian economy, particularly the basic and heavy industry sector. The

advanced capitalist countries have, for long, looked down with disfavour our attempts to become economically independent through the development of basic industries, especially machine producing industries. But, for the first time in the history of economic development in India, we received from the socialist countries aid for building up our heavy industries, iron and steel, oil, coal-mining machinery, and other heavy machine-building enterprises—enterprises which form the 'hard core' of the five year plans. It is not surprising, therefore, that Wilfred Malenbaum had to concede that '....despite the larger assistance from the democratic countries' and despite, what he calls, 'the broader relevance of their more dispersed efforts', '... popular attitudes in India are not more sympathetic to the roles of the West than of the East....It is ironical that it is the countries of the East which may well appear to Indians to be more interested in seeing India achieve its economic and social aspirations'[39].

The qualitative differences between socialist aid and capitalist aid stems from the basic differences between the two economic systems. The priority given to basic industry projects in socialist aid programmes is actually a projection of the internal characteristics of the socialist economy; socialist aid helps the recipient countries to maintain and strengthen their economic independence.

From the point of view of the long-term economic development of the country, the growth of basic heavy industries has a strategic role to play. During the First Five Year Plan almost the entire volume of public foreign capital that India received was in sectors other than basic and heavy industries. This was, of course, in tune with the agricultural bias of the First Plan. With a shift in the strategy of planning in the Second Plan away from the agricultural bias of the First Plan, the Government of India made an attempt to mobilise public foreign capital for the starting of heavy basic industries. The bilateral agreements with foreign gov-

39. Wilfred Malenbaum, *East and West in India's Development* (Washington, 1959) 52.

ernments for the Bhilai, Durgapur and Rourkela steel plants are of immense significance to the economic development of the Indian economy.

Indian imports of steel was continuously increasing ever since the launching of the First Plan. Our steel imports stood at 1.78 lakh tons in 1951 and increased to 1.97 lakh tons in 1952, to 2.48 lakh tons in 1953, to 3.87 lakh tons in 1954 and to 9.04 lakh tons in 1955.[40] It is against this background that we should appreciate the role of these steel projects in reducing India's dependence on steel imports from abroad. India could not go on multiplying her steel imports for a long time without causing a serious drain on her foreign exchange resources. Moreover, in the general matrix of long-term economic growth of the Indian economy, the development of the basic heavy industry sector had a strategic importance. The starting of steel plants with the help of foreign public capital, thus, marked an important turning point in Indian economic development.

The experience gained by India during the First and Second Plans has demonstrated the flexibility of public foreign capital in the matter of planned utilisation of resources. During the First and Second Plans a variety of development projects, agriculture, irrigation, public utilities and social overheads received substantial volumes of capital from foreign public sources. Another significant fact in this respect is the diversion of counterpart funds (funds received from the local sale of agricultural commodities and other goods received as assistance from foreign governments) to a variety of mutually agreed projects.

Difficulties may, however, arise even in the case of public foreign capital if the assistance is tied to specific business sectors[41] according to the preferences of the investing country, much against the specific needs and priorities of the

40. Government of India, Planning Commission, *Programmes of Industrial Development, 1956-61* (Delhi, 1956) 5.

41. The increasing rigidity in the utilisation of United States governmental assistance was reflected in a statement of the United States Under-Secretary of Economic Affairs in which he advocated the earmarking of United States assistance for specific projects.—See the *Indian Express* (Madras) 24 February 1959.

recipient country, or if the assistance is tied to purchases from the investing country only. The United States Export-Import Bank credits, for example, are tied to purchases in the United States. The coal industry in India offers a concrete example of the difficulties posed by such a rigidity in the utilisation of foreign credits. The credit alloted by the Export-Import Bank to the coal industry in India in 1958 could not be fully utilised because the tying of the credit to the purchase of American machinery implied the payment of higher price for the machinery. It was found that American machinery was costlier than similar machinery available in other countries.[42]

These facts, however, do not refute the conclusion that public foreign capital is, in general, superior to private foreign capital in the matter of their flexibility in utilisation. The possibility of channelling public foreign capital to sectors which are vital to the long-term economic development of the recipient country and according to the scale of priorities of the Plan is greater in the case of loans from international public sources.

The social ownership of the means of production in a socialist economy excludes the ownership and use of capital for private profit not only internally, but also internationally. The motive for capital outflows from the socialist countries transcend commercial considerations of profit and centre round larger economic and political considerations of mutual benefit. One such consideration is the weakening of the monopoly position of private foreign capital in the underdeveloped countries by strengthening the public sector and also the anti-monopoly elements in the private sector. Aid from the socialist countries has helped us in enlarging the state sector in India, particularly in sectors where the predominant voice has been that of private investors. Accepting fully what Wilfred Malenbaum advanced as a part truth, socialist assistance for the heavy industry sectors 'constitute a dramatic step toward industrialisation', and by

42. *Hindustan Times*, 22 November 1958. American tenders for the supply of machinery are usually 20 to 80 per cent higher than the bids from other countries.—See *Times of India* (New Delhi) 3 May 1959.

focussing upon the strengthening of the public sector, socialist aid 'serves as a protest against stagnation under colonalism and in favour of equality for the world's second-class citizens'.[43]

The possibility of absorbing superior technical know-how and expertise is one of the major considerations for a recipient country in accepting foreign capital.

If we review the history of international capital movements in the 19th and early 20th centuries, it will be seen that capital outflow from Europe and Britain was either followed by or accompanied by large-scale migration of labour, artisans, and technicians to areas of new settlements. It is estimated that during the fifty years before the First World War, about 60 million people migrated from Britain and Continental Europe.[44] In colonial countries with abundant labour force, for example in India under the British, this phenomenon was substituted by a limited movement of technical and managerial personnel. With the decline in portfolio investments and the considerable additions to the direct equity form of investments, this new trend has almost come to stay. 'No longer do external capital and labour movements tend to complement each other; rather is the relationship one of substitutability.'[45]

Two factors have contributed to this diminution of international movement of labour. Firstly, the growth of industrial labour force in the borrowing countries in adequate quantity and requisite quality and skill to operate general processes of the foreign firms, has made migration of labour force unnecessary. Secondly, with the increase in equity capital with direct control over the operations of the firms, it was found sufficient to import a limited number of technical personnel from the home countries.

It is usually assumed by many economists that the investing country being the more advanced country, the recipient

43. Malenbaum, n. 39, 52.
44. R. Nurkse, 'International investment today in the light of nineteenth century experience', *Economic Journal*, LXIV, December 1954, 744.
45. John H. Dunning, *American Investment in British Manufacturing Industry* (London, 1958) 287.

country can hope to derive the benefits of whatever dynamic qualities that are present in the investing country's economy. Through the investment of foreign capital, therefore, the recipient country can be linked to the industrial and technological progress that is going on in the advanced countries. It is argued that in the sphere of management methods, technical know-how and expertise, this interconnection between the two countries will be to the advantage of the recipient country's economy. The recipient country, through her access to the foreign know-how and through close liason with the progress of industrial research in the investing country, can, with conscious effort, develop domestic skills to an extent at par with those in the investing country.

In the case of private foreign capital in India the above assumptions have little validity. Even a cursory analysis of the actual functioning of foreign firms in India will show this. Foreign firms which have adopted improved technology are generally the ones which are organised on monopolistic lines and involving restrictive practices in the matter of technical know-how. The higher technical knowledge of these monopolistic concerns, instead of getting permeated into the Indian sector, is heavily guarded as business secrets by various restrictive practices including the heavy wall of patent rights.

In India very few foreign firms have systematic research programmes. Only in large-scale industries do we find at least the rudiments of industrial and technical research. Even in the large firms the amount of money spent on research is not very significant compared to the total expenses of the industry.

The experience of the USA shows that for every dollar spent on fundamental research, the new investment needed for utilising the invention in the production process is about 10 dollars.[46] Considering the backwardness of technical skill and the low level of industrial development in India, the

46. R. L. Meier, 'The role of science in the British economy', *Research*, May, 1951.

new capital needed for establishing a new manufacturing process is, in all probability, higher than in the USA. If we consider the comparatively small size of firms in India and the limited resources at their disposal, the huge sums necessary for research and development are beyond the means of many of them.

As individual firms are not in a position to spend large sums on research projects, research tends to be a cooperative effort. Industries in which the foreign companies have organised central associations have undertaken non-operative expenses such as expenses on research and technical innovations.

In the absence of business associations in many sectors, research tends to be a function of only large firms. Specialisation of production process which is an inevitable consequence of higher forms of industrial organisation and innovation, can be effected with advantage only by large firms. Only firms of sufficiently large size can devote generous sums on research and thereby derive a competitive advantage over small competitors in the field.

With the increasing importance of international institutions and foreign governments as the sources of foreign capital, the form of technical know-how that India can mobilise has undergone quantitative and qualitative changes. In the hey-day of international private capital, technical know-how was brought to India along with the import of foreign private (direct) capital. With the increasing role of international public capital, absorption of technical know-how has taken the form of specific technical assistance agreement with international institutions and governments of creditor-countries. Compared to the manner in which technical assistance was given to India in the earlier periods, particularly in the early British period, the technical assistance programmes initiated on a bilateral or multilateral basis fit in more with the specific needs of the Indian economy.

The fields in which technical assistance was provided in the past to dependent territories by foreign capitalists

> and the metropolitan powers were determined largely not by the needs of the peoples in the area concerned but by the interests of the foreign investors and of the metropolitan governments. In a number of cases, the result was the reckless exploitation of natural resources and unbalanced economic development.[47]

In relation to the enormous need for technical assistance in India and the other underdeveloped countries, it can be concluded that the technical know-how which can be mobilised along with an import of private foreign capital is inadequate. We have to rely more on bilateral and multilateral arrangements.

In the matter of absorbing foreign technical know-how, the steel plant agreements which India has entered into with USSR, the United Kingdom and West Germany offer us sufficient scope for fruitful comparison. As the building up of a steel plant involves the appointment of a large number of technicians, skilled workers and qualified engineers, the provision for training Indian nationals is of great significance. Let us take the example of the Bhilai steel plant.

The Indo-Soviet agreement on the Bhilai steel plant offers an example of how a recipient country can absorb maximum benefits through the training of domestic personnel in technical and managerial work. Training of Indian personnel for the Bhilai steel plant was carried out through two channels: (i) the training of Indians at the various iron and steel works in India where Soviet specialists acted as consultants, and (ii) the training of Indian nationals at the iron and steel works in the Soviet Union. During 1956-8, about 190 Indian engineers and technicians and about 500 Indian workers were given practical training in various aspects of the industrial processes at the Soviet iron and steel works.[48]

The performance of the Rourkela steel plant, constructed with West German aid, on the other hand, has been largely

47. P. S. Narasimham, 'Technical assistance for economic development of underdeveloped countries', *India Quarterly*, VI, 2, April-June, 1952, 145-6.

48. *AICC Economic Review*, 15 April 1957, 23.

negative in this respect. The West German engineers in charge of this steel plant have been directly or indirectly standing in the way of Indian engineers acquiring the necessary technical know-how at the level of implementing blueprints and the important details of construction. T. N. Singh was basing himself on first-hand knowledge when he stated that, 'I have a feeling that our engineers and technicians who are supposed to be attached to these people are not getting the full know-how. They are probably in the dark'.[49]

Technical advancement being cumulative, the technical know-how and equipment of the advanced countries (which are incidentally the donor countries or investing countries) will increase at a very rapid rate leaving India and other underdeveloped countries farther away in the path of progress. The possibility of a rapidly increasing gap in the technical know-how levels of the investing and recipient countries demands concerted measures on the part of the recipient countries.

There is definite advantage in importing foreign technical know-how only if the ultimate purpose of such a measure is the technical training of Indian nationals. The help of foreign technicians and experts is justified if it is a temporary measure which will finally enable the domestic institutions and personnel to acquire the higher technical know-how of the advanced countries. As the U.N. reports has correctly pointed out, 'Plans for economic development need to begin with the expansion of the domestic institutions for training the personnel required at all levels'.[50]

There is an erroneous tendency in many quarters to clamour for foreign techniques and equipment without investigating the capacity of the domestic industries to adapt the imported technology. An unimaginative adaptation of foreign technology may cause irksome dislocations in the

49. Speech of T. N. Singh (a former Chairman of the Public Accounts Committee and now member of the Planning Commission) in Lok Sabha on 1 April 1958.

50. United Nations, *Measures for the Economic Development of Underdeveloped Countries*, para 83.

industry. Therefore, modern equipments from abroad should not be transplanted into the Indian set-up without looking into local requirements. The peculiar conditions in India, the relative cost of the factors of production, the scarcity of capital resources and the relative abundance of labour power, all these should be taken into account before a decision is taken to import a foreign technology. For example, the social cost arising from the possible replacement of large sections of the labour force should be an important consideration in adopting a labour-saving technique or a modern method of rationalisation. Again, it should be remembered that '... no development is lasting or self-generating which is merely imposed from above, or imported from abroad. The new education and technique will show large results only when they are completely assimilated, and begin to develop on lines of a native tradition'.[51]

An important criticism levelled against the system of bilateral assistance of the United States is that it attaches conditions aimed at discriminatory measures which hinder trade with underdeveloped countries. A substantial part of the US foreign aid is tied to considerations favourable to the American market. The Development Loan Fund, for instance, places 'primary emphasis on the financing of goods and services of US origin',[52] when the loans are intended for financing the foreign exchange costs of the development projects. According to a Report to Congress on Mutual Security Program, the 'direct and indirect benefits' which accrue to the American economy from this 'buy American' policy include

> (1) the purchase of necessary equipment and materials in the United States, (2) the acceleration of economic growth results in an increase in US foreign trade, and (3) the creation of additional sources of goods not produced in the United States[53].

Similarly, the US Export-Import Bank generally gives credit

51. *Ibid.*
52. United States, *Report to the Congress on Mutual Security Program* (for the fiscal year 1960) January 1961, 82.
53. *Ibid.*, 83.

only to finance purchases of materials and equipment of American origin and of technical services of American firms and individuals and not for goods, labour and services in the borrowing country or in third countries. As the Bank's general policy statement puts it,

> ... the Bank makes only loans and guarantees which serve to promote the export and import trade of the United States. The Bank promotes foreign trade directly by financing specific export and import transactions. The Bank promotes foreign trade indirectly by financing exports in connection with productive developments and thus assisting in building up the economies and in raising the income levels of borrowing countries, which thereby become better markets for American products and better suppliers of imports required by the United States.[54]

Thus the old colonial attitude of securing, through foreign investments, markets in the investing countries and ensuring the import of necessary commodities from them, lingers on. In the allocation criteria of US aid in general, the possible effect of the aid upon American trade and industry is one of the decisive considerations.

The general criticism that political implications and considerations of military strategy are involved in the foreign aid programme of the United States seems to be well-established. The massive programme of foreign aid undertaken by the US government both through bilateral and multilateral channels, is clearly not based entirely on economic or humanitarian considerations. Foreign aid, particularly of the bilateral type, is 'a major tool of foreign policy'.[55] One of the reports on Mutual Security Programme submitted to the US Congress noted:

> For a number of political and economic reasons, US assistance is given through both bilateral and multilateral channels. Bilateral assistance has the advantage of furthering US foreign policy objects directly.[56]

54. Export-Import Bank, *General Policy Statement,* 1 August 1947, 5.
55. Malenbaum, n. 39, 52.
56. N. 52, 5.

The shift of emphasis in the United States from Marshall Plan and Foreign Economic Assistance to Mutual Security was dictated by political and military considerations. In fact, economic, political and military implications have all been mixed up in the US foreign aid programmes. Very often, leading spokesmen of US government have not cared to make a clear distinction between economic aid and military aid. The linking of economic and military aid may be in tune with the foreign policy objectives of the US, but such linking only provokes resentment among the people of the recipient countries. The practice of grouping military and economic aid into a single foreign aid programme may be 'sound short-term political strategy' in the local elections in the United States, but it is 'long-term dynamite abroad'.[57]

An important component of aggregate US aid to countries abroad is in the form of military subsidies and subsidies to prop up decadent, feudal and reactionary governments who pledge support to the United States. In addition, substantial amounts have been invested in the construction of air bases, strategic roads and various types of 'strategic infrastructure' in the recipient countries. All these investments of an essentially military and non-economic character clearly form the life-blood of imperialism today. 'Thus in practice imperialist so-called "aid" is a form of neo-colonialism, commonly accompanied with economic, political and even military strings'.[58]

A serious defect of the foreign aid programmes of some of the industrialised countries is the lack of coordination and continuity. Various governmental agencies in the lending countries operate in more or less the same area in the foreign aid field. This results in overlapping of functions and undue concentration of foreign aid resources in a few limited spheres of activity in the recipient countries. As Eugene Black, former President of the World Bank admit-

57. Wil Marcus, *U.S. Private Investment and Economic Aid in Underdeveloped Countries* (Washington, 1959) 2.
58. R. Palme Dutt, 'Neo-colonialism and British Imperialism', *World Marxist Review*, II, February, 1962, 14.

ted in his address to the annual meeting of the Bank's Board of Governors in September 1956:

> Despite the existence of an unprecedented flow of development assistance out of the industrialised countries today,... all too often development assistance lacks continuity and provides an inadequate basis for the advance planning of development projects.[59]

The lack of continuity is very often due to the fact that short-term political and economic considerations circumscribe the foreign aid policies of the lending countries. For instance, the International Cooperation Administration and the three agencies preceding it had to work for about a decade in an atmosphere of uncertainty regarding their future. Even though the programmes were extended from year to year, in the absence of clear assurance that the programmes would be continued, no long-term planning about aid allocation and utilisation was possible. As Wil Marcus observes, 'the ICA, through no fault of its own, has had to spend its money not with reference to any long-term plan, but rather on crash programmes to meet emergencies'.[60] This position has, no doubt, changed to a certain extent in recent years as a result of reorganisation of the institutional framework of the US public foreign aid. The new organisation, the Agency for International Development (AID), has taken over the functions of the International Cooperation Administration and the Development Loan Fund. Administration of the local currency funds arising out of the P.L. 480 commodity sales is also within the purview of AID. Now there is greater degree of coordination in US foreign aid programmes than what was visible before the creation of AID.

United States foreign aid programmes were originally evolved in response to temporary needs of friendly countries. It was not the intention of the early exponents of US foreign economic policy to make foreign aid a permanent responsibility of the American government. But develop-

59. IBRD, *Summary of Proceedings: Eleventh Annual Meeting of the Board of Governors* (September, 1956) 11.
60. Wil Marcus, n. 57, 2.

ments in the world economy, the widening gap between the income levels of developed and underdeveloped countries, and the rising competition offered by the socialist countries, have compelled the US government to accept foreign aid as an unforeseen but continuing responsibility. In the evolution of US foreign aid policy, however, a conscious attempt to continuously re-tool its aid programmes in the light of changing conditions in the world economy and the world balance of political and economic power is clearly evident. The 'patchwork basis' of US foreign aid programmes is highlighted by the numerous and sometimes abrupt alterations in foreign aid policy to meet the ever-changing military and diplomatic requirements of the cold war.

Sometimes foreign aid is available only in 'homeopathic doses'. The divergence between the needs of the recipient countries and the actual amounts made available to them is quite striking. Even the small amounts are, in certain cases, offered grudgingly and after prolonged hesitation.

Insufficient amounts of foreign assistance may, sometimes, be disastrous. Instead of registering the beneficial impact of foreign aid it may only highlight the defects of incomplete and inadequate development projects. Instead of creating an appreciative response from the people of the recipient country, it may only breed frustration or irritation. Moreover, insufficient aid, while itself incapable of solving the economic problems of the recipient country, may aggravate the existing problems through the free play of the 'demonstration effect'. American aid, for instance, is always a sure way of bringing about the encounter between the low standard of living of the recipient countries and the affluence of the American economy. Any attempt on the part of the people of the recipient countries to adopt or even to imitate the consumption habits in the United States is bound to create problems for the recipient countries. It will, no doubt, have serious repercussions on domestic savings. Moreover, the divergence between ambition and fulfilment is likely to stir up political and social tensions.

In the economic literature dealing with foreign invest-

ments, one often confronts over-emphatic and exaggerated statements about their beneficial role. Even among Indian economists we notice the tendency of giving an exorbitantly high weightage to the role of foreign capital. The following passage bears testimony to this: 'International (private) capital movements have been the prime movers of economic progress bearing the fruits of technical advancement and scientific progress in their train from country to country'.[61] It can be readily admitted that foreign investments have played an important part in the economic development of many countries. But it will be an exaggeration to assert that they have been the 'prime movers' of economic progress. While foreign capital has given the added momentum and, in certain cases, the external stimuli to internal growth, the prime movers of economic development have always been the capacity of a country to raise its domestic capital resources and the inner dynamism and vitality of the masters of economic resources in the country. About Japan's economic development Edwin P. Reubens writes:

> In that evolution, foreign capital made a critical contribution, although it was neither the prime mover nor the principal source of support. Dependence upon outside assistance was minimized by strenuous domestic activities....[62]

The experience of the Soviet Union, although different in many ways to that of Japan, also points to the same conclusion. It is true that the First Five Year Plan of the Soviet Union had anticipated that a considerably wider expansion of economic intercourse would take place with the world economy and a much greater increase in long-term credits from abroad in the early years of the Five Year Plan. The First Plan of the Soviet Union was 'based on the assumption that there would be a considerable expansion in the

61. B. K. Madan, 'Forms of foreign investments', *India Quarterly* (July-September, 1952) 221.
62. Edwin P. Reubens, 'Foreign capital and domestic development in Japan', *Economic Growth: Brazil, India, Japan*, ed. by Simon Kuznets etc., 179.

economic intercourse between the USSR and capitalist world economy'.[63] But due to various historical reasons, the Soviet Union had to rely almost entirely on her own resources. The amount of external resources received by the Soviet Union was quite negligible.

> For any given amount of reconstruction and economic development... there is usually the opportunity to carry it through with varying degrees of assistance from abroad. At one extreme there is the case of virtually no assistance from abroad. The remarkable industrialisation of Russia in the last thirty years nearly coincides with this theoretical pattern.[64]

The example of countries like Japan and the USSR point to the possibility that rapid growth is possible without recourse to foreign capital to any significant extent. They show how a poor country can initiate rapid and deliberate industrialisation by mobilising domestic capital to the utmost and relying on external resources only to the bare minimum required.

The planned growth of the Indian economy rests primarily upon the level of domestic savings and effort and the various propensities of self-growth. Foreign capital plays a beneficial role in this domestic developmental effort by providing the additional or marginal effort and bridging the gap between domestic savings and the outlay contemplated in the development plan. In this respect, foreign capital plays an auxiliary or secondary role. Foreign capital should be conceived of as a method of supplementing the domestic capital resources. Any development plan that considers external capital as the 'prime mover' of economic growth is bound to sterilise indigenous initiative and the inventive capacity of domestic enterpreneurs. In other words, we should be conscious of the possible danger that may arise from undue reliance on foreign assistance in the direction

63. *Summary of the Fulfilment of the First Five Year Plan for the Development of the National Economy of the U.S.S.R.* (New York, 1934, 2nd edn.) 18.

64. Norman S. Buchanan, *International Investment and Domestic Welfare* (New York, 1945) 111.

of reducing the people's willingness for self-help and the propensity of the domestic economy for self-growth.

It should be remembered that a mere shortage of liquid funds do not justify the indiscriminate import of foreign funds. Any bottleneck that may appear in the matter of mobilizing financial resources from within the country must be overcome through monetary and fiscal tools. Once the maximum utilisation of indigenous resources has been ensured, the gap that may remain between planned outlay and domestic resources may be sought to be filled up by resort to foreign capital. It should be noted that 'The role of foreign finance in economic development can therefore only be of a subordinate character'.[65]

The need for mobilizing the maximum magnitude of domestic capital apart, there is another area where India, and for that matter any recipient country, has to be vigilant. The scarcity of international capital that the world is witnessing today (scarcity in relation to the total needs of the underdeveloped countries) demands that foreign resources should be utilised with utmost care and strict allocation planning to see that the scarce foreign resources are channellised to sectors of priority and for the import of scarce capital goods, intermediate products and raw materials.

The role of foreign capital in the economic development of India and other underdeveloped countries can be described by reference to their 'catalytic properties'. The catalytic properties of foreign capital refer to its capacity to ignite an initial sparkling for a sustained national effort. In other words, the import of foreign capital should be conceived of as a relatively short-term measure to start a self-generating domestic process of economic development. In this sense, foreign capital may provide the additional marginal effort for the recipient country to take-off.

This has another aspect too. The catalytic properties of foreign capital also involve the termination of foreign capi-

65. United Nations, *Methods of Financing Economic Development in Under-developed Countries* (New York, 1949) 94.

tal inflow once the initial ignition of domestic effort is achieved. After initiating the process of self-growth, the need for foreign capital should taper off and there must be a point in time when the inflow of foreign capital creates pre-conditions for its discontinuance. In other words, the import of foreign capital should be directed in such a way as to minimise after a stage and remove in the future the very need for importing foreign capital. This means that foreign investments should be largely of a self-liquidating character.

Planning requires a certain degree of certainty about the availability of resources necessary for financing the plan. The government or the planning authority of the country can assume complete control over the mobilization of domestic resources because the state is sovereign within its own territorial boundaries. But, the state cannot, either in the legal or in the practical sense, assume the same type of control over the mobilization of external resources. Depending upon the ability of the government to influence the direction of international investments, external resources may or may not be forthcoming for financing the national plan. Even if foreign capital flows into the country in the desired magnitude at the beginning of the plan, its continued inflow cannot be guaranteed by the unilateral action of the borrowing country. This creates uncertainty in planning. Moreover, the strains and burdens caused by the shortfall in external assistance may be serious if the shortfall occurs in a sudden and unexpected manner. Therefore, a programme of economic development which assigns a major role to foreign capital cannot be built on a sound and strong foundation. If certainty is the essence of planned action, it follows that we cannot rely too much on external finance.

Foreign capital has, undoubtedly, a useful role to play in the economic development of India. But it should be conceived of as a supplementary source and not as a substitute for domestic capital. The dynamics of the Indian economy, in the final analysis, will depend on the domestic economic variables.

Chapter VIII

Policies and Measures Affecting Foreign Investments

IN THE realm of India's foreign economic relations there are very few problems which have acquired greater importance than the problem of international finance for India's economic development.

The problem of foreign investments was, no doubt, a problem of sufficient concern in the pre-independence period dating back to the days of the East India Company. However, the attainment of political independence in 1947 gave the entire question of foreign financial obligations and the working of foreign enterprises in India a new complexion.

This new complexion in India's approach to foreign capital was, in a sense, the product of two important developments. On the one hand, the intensity of India's hostility to every form of foreign capital (hostility created in no small measure by the colonial attitude of the British government to foreign capital penetration in India as the one-sided and often negative approach of at least one facet of the national sentiment) declined into a position of qualified welcome to foreign capital. On the other hand, the increasing needs of economic development initiated under the leadership of the bourgeoisie provided the necessary pressure for relying on foreign finance. This, in effect, was reflected in the pragmatic approach of the government towards foreign capital in the post-independence period.

The evolution of official policies towards foreign capital after August 1947 and the changes that have occurred in the attitude of different sections of the people towards foreign capital penetration constitute an interesting study

in itself. Up to August 1947 the policy of the Government of India was one of permitting unconditional and unrestricted inflow of foreign capital while general public opinion was for a restrictive policy towards it. The political changes in 1947 resulted in a realignment of attitudes and in many quarters there was evident a change from opposition to warm welcome to foreign capital.

After independence the Government of India's policy with regard to foreign capital was formulated, for the first time, in the Industrial Policy Resolution of 6 April 1948. The government recognised that 'participation of foreign capital and enterprise, particularly as regards industrial technique and knowledge, will be of value to the rapid industrialisation of the economy'[1]. About the need for foreign capital and the government's attitude to it Prime Minister Nehru stated in April 1949:

> Indian capital needs to be supplemented by foreign capital not only because our national savings will not be enough for the rapid development of the country on the scale we wish, but also because in many cases, scientific, technical and industrial knowledge and capital equipment can best be secured along with foreign capital.[2]

It was a general exposition of the policy of overall welcome to foreign capital adopted by the Government of India and was intended 'to inspire foreign capital with confidence so as to attract it....'[3] Referring specifically to British interests which constitute the bulk of foreign investments in India, the Prime Minister stated:

> Although it is the policy of the Government of India to encourage the growth of Indian industry and commerce (including such services like Banking, Shipping and Insurance) to the best of their ability, there is and will be considerable scope for the investment of British capital in India. These considerations will apply equally to other existing non-Indian interests. The Government of India

1. *Constituent Assembly of India (Legislative) Debates*, V, 1, 3296-7.
2. *Ibid.*, IV, 1, 2385.
3. Homi Mody's speech in the Constituent Assembly, 6 April 1949 (*ibid.*, IV, 1, 2415).

> have no desire to injure in any way British or non-Indian interests in India and would gladly welcome their contribution in a constructive and co-operative role in the development of India's economy.[4]

The policies of the Government of India with regard to foreign capital as embodied in the Industrial Policy Resolution of 6 April 1948, and the statements of the Prime Minister were further strengthened by the statements of the ministers in charge of finance, industry and commerce.[5] Their pronouncements have attempted to give clear-cut assurances to foreign investors regarding non-discrimination in applying the Industrial Policy Resolution, reasonable facilities for the transfer of investment income, repatriation of capital, and fair and equitable compensation in the event of nationalisation. Underlining the role of foreign capital in the industrial development of India, the Finance Minister in his speech introducing the Budget for 1950-51 stated in parliament that 'foreign capital is necessary in this country not merely for the purpose of supplementing our own resources, but for the purpose of instilling a spirit of confidence among our own investors'.[6]

The Prime Minister's statement in the Constituent Assembly on 6 April 1949 had pointed out that the

> Government would expect all undertakings, Indian or foreign to conform to the general requirements of their industrial policy. As regards existing foreign interests, Government do not intend to place any restrictions or impose any conditions which are not applicable to similar Indian enterprise. Government would also so frame their policy as to enable further foreign capital to be invested in India on terms and conditions that are mutually advantageous.[7]

The 'terms and conditions that are mutually advantageous'

4. N. 1, IV, 1, 2386.
5. *Parliamentary Debates, House of the People*, III, 5, 3661. See also *Parliamentary Debates, Council of States*, II, 1, 119-120.
6. Finance Minister Dr. John Mathai's speech in Parliament introducing the Budget for 1950-51.
7. The Indian Prime Minister's statement on foreign investments in India made in the Constituent Assembly, 6 April 1949, *Constituent Assembly of India (Legislative) Debates*, IV, 1, 2385.

have not been clearly explained in detail by the government. However, the Government of India's preference for equity capital was indicated by the Finance Minister who stated in parliament that

> . . . any considerable assistance in the way of capital from foreign countries must hereafter be looked for not in the shape of fixed interest-bearing loans and bonds, but in the shape of equity capital on the basis of joint participation on strict business considerations without any political strings attached to it. I consider that knd of assistance desirable from our point of view, and feasible from the point of view of the foreign investor.[8]

It is the claim of the Government of India that they have welcomed 'the use of foreign capital in India in a manner which will redound to our interests'.[9] Foreign enterprises are expected to function in a manner consistent with India's national interests and in accordance with the Government of India's industrial policy. The government, on its part, has assured foreign investors that 'there will be no discrimination either in favour of or against foreign investors. Neither will they get special privilege nor will they be subjected to any special disabilities'.[10] The government has also declared that it would extend equal treatment to foreign and Indian concerns in order to create a proper climate for foreign investments in India.

> As regards foreign capital, Government have declared, without any reservation, that all industrial undertakings registered in India will be treated alike, independently of the consideration whether the interests are Indian or foreign.[11]

The Minister for Commerce and Industry stated in the Lok Sabha on 4 April 1953:

8. N. 6.
9. Minister for Production and Supply, Shyama Prasad Mookerjee's statement in the Constituent Assembly, 7 April 1948, *Constituent Assembly of India (Legislative) Debates*, V, 2, 3394.
10. N. 1, IV, 1, 2426.
11. Remarks regarding the climate for foreign investments in India made in the United States in October 1949 by Dr. J. C. Ghosh, Director General of Industries and Supplies, Government of India. See, *India Invites Foreign Capital* (New York, 1950) 12.

> We have . . . a fairly close system of control over industry . . . . Government have ample powers . . . to ensure that private industry does not act in any manner inimical to national interests and also plays a fair game towards the consumer. Those powers apply to foreign-owned firms no less than to Indian-owned firms. Neither the one nor the other can be allowed to pursue anti-social policies or exploit the Indian consumer. Subject to these safeguards, which I may repeat are non-discriminatory, and any specific conditions imposed at the time of entry, we give to foreign firms fair and equal treatment and I am quite satisfied that it is in the interests of the country and millions of people who inhabit it.[12]

The fourth meeting of the Central Advisory Council of Industries gave approval to government's policy towards foreign capital.[13] The policy as embodied in the Industrial Policy Resolution of 1948 was further modified in the Industrial Policy Resolution of 30 April 1956. But basically, the policy remained one of general welcome to foreign capital.

The policies and measures affecting foreign investments in India can be classified under the following groups:

(a) those affecting entry and authorisation of foreign investments;
(b) those relating to transfer of income and capital;
(c) those relating to operational aspects such as division of ownership between foreigners and nationals, employment and training of nationals;
(d) those relating to taxation; and
(e) those relating to nationalisation.

Entry and Authorization of Foreign Capital

The Industrial Policy Resolution of 1948 stipulated that suitable legislation should be provided for 'the scrutiny and approval by the Central Government of every individual case of participation of foreign capital and management in

12. T. T. Krishnamachari's speech in Parliament, April 1953, *Parliamentary Debates, House of the People*, III, 5, 3662.
13. The fourth meeting of the Central Advisory Council of Industries held in New Delhi in October, 1953.

industry'.[14] It explicitly stated that 'the conditions under which they may participate should be carefully regulated in the national interest'. 'The Government expect the foreign enterprises to function in a manner which redound to our national interests' and in a way consistent with its industrial policy. However, the practical question of determining the sectors where foreign capital is to be allowed and the exact conditions of foreign capital participation were placed on an 'ad hoc' basis. Thus, the policy statements of the government were more in the nature of reflections of good intentions rather than firm pronouncements of policy backed up by continuous practice and a permanent machinery for action.

Authorisation or official approval is required for importing foreign capital and starting a foreign-owned project. There are mainly two methods by which foreign companies can start their business in India. One method which they can adopt is to register the parent company in India. The second method is to register the company as a subsidiary of the parent company. These methods involve the usual process of registration. The foreign companies are free to choose the method which suits them. The Indian Company Law puts no restriction on the adoption of any of these methods; but they have to comply with all the formal requirements of law laid down for the purpose.

The Indian Companies Act, 1913, provided that companies established outside India, if they wanted to start a place of business in India, should file with the Registrar in the province where the principal place of business is situated, certain documents within one month from the establishment of such place of business.[15] The Companies Act, 1956, also made a similar provision.[16] The documents to be filed included a certified copy of its Memorandum and Articles of Asso-

14. N. 1, V, 1, 3296-7.

15. Government of India, Ministry of Law, 'Indian Company Act, 1913', *The Unrepealed Central Acts*, VI, 399. See Sections 277-277E of the Act.

16. Government of India, Ministry of Finance, Department of Company Law Administration, *A Layman's Guide to the Indian Company Law* (New Delhi, 1956) 157.

ciation, and the name and address of the individual in India competent to receive notices served on the company. Such companies are also required to file its annual balance sheets every year. The balance sheets should contain all the information which any company registered in India has to furnish.

A company, whether incorporated in India or outside, if it wants to make an issue of capital in India or make a public offer of securities for sale or renew or postpone the date of maturity or repayment of any security maturing for payment in India, has to obtain the consent of the Government of India. These regulations were introduced under the Capital Issues (Continuance of Control) Act, 1947.[17] Companies proposing to make the issue of capital were to submit their application for consent to the Controller of Capital Issues, Ministry of Finance, Government of India, Department of Economic Affairs, New Delhi. The application was to be made in a prescribed form in which full particulars about the company and the manner in which it proposes to spend the proceeds of the cash issue have to be given.

The Government of India recently simplified the procedures with regard to licensing of enterprises with equity below Rs. 25 lakhs. Under the new procedure, such enterprises are not required to possess licences, but would be given approval of the government in a simple manner. Even for other enterprises, industrial licences are not now being issued in the first instance. Initially a 'Letter of Intent' is issued to the applicant which specifies the time limit within which the applicant should take some specified steps. If, within this period, satisfactory progress is not made with regard to these specified steps, the government can, under the new procedure, cancel the Letter of Intent and release the capital thus made available to other applicants. The period of validity of a Letter of Intent, of course, varies from industry to industry depending upon the nature of the case. The government has also power to extend the period, if found necessary.

17. Government of India; Ministry of Law, 'The Capital Issues (Continuance of Control) Act, 1952', Act No. VI of 1962, *Supplement to Central Acts*, IV, 1952, 11.

The new system of granting Letters of Intent serves an important role in cutting short the irksome procedural delays involved in the complicated licensing procedure in India. In addition it avoids wasteful 'booking of capacity'. Earlier, it was quite difficult, under the law, to revoke a licence even if the capacity was not created by the companies possessing the licence within a long period. Now, under the new procedure, capacity cannot be booked by such non-serious applicants for more than four months.

When applications are made for the establishment of new foreign enterprises in India, the project is supposed to satisfy the general test of economic usefulness. But this 'economic usefulness' is not clearly defined by the government. There is no clear-cut standard on the basis of which every proposal is judged. In the absence of some yard stick to measure the 'economic usefulness', the decisions of the government, on many occasions, have been contrary to the economic interests of the domestic economy. The criteria used have often varied according to the exigencies of the situation. Putting them on an 'ad hoc' basis has also led to a lack of consistency in governmental decisions.

Any attempt to discern the basic considerations involved in the permission of entry and authorisation of foreign capital has to be based on a detailed study of the various 'ad hoc' decisions which the government has taken from time to time. An analysis of the reasons given by the government for rejecting the proposals for the new entry of foreign capital will be particularly useful.

On certain occasions, the government has rejected the proposals for the new entry of foreign capital. For instance, during 1951-2, applications for investment of foreign capital in India were received from 6 parties and they were all rejected. In a statement made by the Minister of Commerce, it was shown that the applications rejected were for investments in various industries such as pharmaceuticals, rubber factory, manufacture of printing inks and printing materials, thermit welding of railway joints, manufacture of welding portions and other incidental equipment thereto, ferrous

alloys, manufacture of toothbrush, fountain pen ink, etc.[18]

The reasons for rejecting the applications for the entry of foreign capital depend upon many considerations such as the nature of the item of manufacture, its quality, demand, etc., all decided on an 'ad hoc' basis. In certain cases where it was found that local production in the industry was sufficient to satisfy the needs of the country, additional investment through the entry of foreign capital was not entertained. For example, in the case of a proposal from the Canadian firm of Frank W. Horner Ltd. for the manufacture of pharmaceutical products in India, the Government rejected the application on the ground that 'such products are already being made on an organised scale by several firms in India and the local production is enough to meet the country's requirements'.[19]

Apart from the question whether the existing industries in India can meet the domestic needs, the quality of the product which the foreign firm proposes to turn out is also an important consideration. In 1951-2, the proposal of the London firm of Kautex Ltd. for the establishment of a rubber factory in India was rejected since the plant which was proposed to be imported was 50 years old and the government considered that 'it would not be possible to manufacture goods of requisite quality.'[20]

Another consideration which has governed the granting of entry to foreign capital in certain cases has been the extent to which Indian capital is allowed to participate in the business of the foreign company. Usually, a scheme which envisages majority status to Indian capital is given preference. In certain cases, the government had rejected applications for entry which involved a majority share to foreign capital and a minority share to Indian capital, the proportion of which, in the opinion of the Government, was not justified. For example, in 1951-2, in the case of the proposal of A. B. Fleming Co. (Holding) Ltd., Edinburgh, to start busi-

18. Statement before the Council of States by D. P. Karmarker, 24 November 1952. *Parliamentary Debates (Council of States)* II, 1, 30-31.
19. *Ibid.*, 30-31.
20. *Ibid.*

ness in India in the manufacture of printing inks and printing materials, the government pointed out, as one of the reasons for rejecting the proposal, that it involved majority of foreign capital which was not justified in this case'.[21] At the same time, if we look at the various instances where the government never insisted on the participation of Indian capital, it will be clear that this principle has not been implemented in a consistent manner.

Foreign participation may be sought occasionally in the form of royalty payments. In such cases, the decision as to whether it should be allowed or not depends upon considerations such as the rate of royalty, the nature of the item of manufacture, and necessity of acquiring technical know-how. Generally, a rate of 5 per cent on sales is the maximum rate of royalty allowed. In certain cases, the Government of India have rejected the entry of foreign capital on the ground that the royalty arrangements were not justified. For example, in the case of Biro Pens Ltd., a London firm, which proposed to manufacture ball-point pens in India, the government rejected the application since 'the proposal also involved payment of royalty which was not considered justified'[22]

A recent case is that of Westinghouse International, an American company which proposed collaboration with W. S. Insulators, Madras, for the manufacture of fuse cutouts. The terms of collaboration included (i) a lump-sum payment of $ 30,000 and (ii) royalty of 5 per cent, subject to taxes and subject to a minimum of $ 5,000 per annum. The Government of India considered these terms unacceptable and asked the Indian firm to negotiate on the basis of a royalty of 3 per cent, subject to tax, but without any provision for a minimum payment.

Even though the general policy of the government has been to insist upon a maximum of 5 per cent royalty, in certain cases it has made exceptions to this general rule. For instance, in the case of certain items of machine tools,

21. *Ibid.*
22. *Ibid.*

royalty up to 7.5 per cent has been allowed. The possibility of departure from the declared policy is, thus, wide open, depending upon 'ad hoc' considerations and exigencies of the time.

As a general rule, wholly-owned subsidiaries of foreign firms in India are not permitted to pay royalty to their principals. Compared to capital participation, royalty arrangements with purely Indian capital will be given preference, provided they turn out high-quality products.

The policy of the Government of India in recent years with regard to Indo-foreign collaboration agreements has been characterised by a complete absence of national considerations. It is true that some collaboration agreements do bestow certain advantages to the Indian economy, for instance, the import of better technology and consequent speeding up of industrialisation. But it is also true that some other collaboration agreements contain provisions which are detrimental to the interests of the national economy. Some of the agreements sanctioned by the government stipulated that the goods produced with the help of foreign technical know-how should not be exported. Such provisions meant to safeguard the market control of the foreign companies are clearly opposed to our vital interests in the field of export promotion. Lately there has been some realisation on the part of the government of need to review some of the positively harmful agreements, but the vagueness and undue flexibility of interpretation that is characteristic of the government's policy in this respect seems to prevent a complete departure from the existing practices. It is perhaps time that the government undertake a detailed examination of the foreign exchange implications of foreign collaboration agreements.

A study of the Indo-foreign collaboration agreements in the private sector shows that the government has very often given permission for such collaboration even in respect of a number of non-essential items of production. The official claim that they have recently tightened up the whole machinery of granting permission to such ventures do not seem to have much substance. In spite of repeated statements to

the contrary from official circles, permissions are still being given for producing, under collaboration agreements, non-essential goods or goods of very little Plan priority. Collaboration agreements covering the production of consumer items such as refrigerators, air conditioners, cameras, gramophone records, shoes, ball-point pens, dolls, and condensed milk constituted about 10 per cent of the total number of collaboration agreements entered into 1960 and 1961. It is surprising that the government continues to give sanction to such collaboration agreements at a time when the economy is straining every nerve to conserve and increase its foreign exchange reserves. Undue anxiety to attract foreign capital without adequately examining its foreign exchange cost should be clearly avoided.

The Industry Policy Resolution specifically included minerals such as copper, lead and zinc among the category of minerals whose mining and processing was to be undertaken only by the state. But the need for propitiating foreign interests and thereby encouraging both private and public foreign capital, from the capitalist countries, the Government has, in certain cases, gone against their own policy pronouncements. For instance, the government gave permission to Rio Tinto, an international metal combine to enter into partnership with India Metal Corporation for expanding the programme of exploiting zinc and lead deposits at Zawar in Rajasthan. Under this agreement, Rio Tinto has been allowed equity participation to the extent of 40 per cent. It is not clear why the government did not enlist the cooperation of socialist countries to undertake that project in the public sector.

There is no coordinated and systematic procedure with the Government of India by which foreign investment proposals can be screened. Decisions are taken on an 'ad hoc' basis with only such vague considerations as the 'economic usefulness' of investment projects as the criteria for giving entry. The lack of a well-defined policy in this respect has, in effect, meant the granting of a blank cheque to foreign investments. Even the 'ad hoc' considerations which governed the government's decisions regarding the restriction

on the entry of foreign capital in the early stages seem to be placed in cold storage:

> ... a substantial number of cases could be cited of countries that welcome foreign private capital without any substantial reservations. The Government of India has taken this position lately and its recent agreement with the Standard Vacuum Oil Company concerning the creation of refineries bears out its declarations.[23]

Two significant facts about the government's policy in regard to entry and authorisation of foreign capital are, firstly, the divergence between declared policy and its actual implementation, and secondly, the continuous relaxation of accepted procedures in order to achieve an unrestricted inflow of capital. It would be to the advantage of the Indian economy and to the convenience of the foreign investors if government's policy and procedures governing the granting of entry and authorisation to foreign capital is defined in clear and precise terms. It seems that the divergence between professed policies and actual practice is partly due to the fact that only general policies are laid down within which there is considerable room for flexibility. Flexibility may be a virtue in certain circumstances, but giving complete latitude for administrative discretion will be suicidal to national interests. From a national point of view, it needs to emphasised that such a policy should be based on the relative cost and benefits of the investment projects. No 'open door' policy towards foreign capital can be considered as something which redounds to our national interest.

A danger which we should avoid in the formulation of a policy towards foreign investments is the preoccupation with short-term considerations. The fact that many economists in India are liable to commit this misake of 'short-sight' was evident during the foreign-exchange crisis of the first two years of the Second Five Year Plan. It has been often argued that in view of the serious foreign exchange gap, we should devise a policy of complete flexibi-

23. Norman S. Buchanan and Howard S. Ellis, *Approaches to Economic Development* (New York, 1956) 344.

lity which would allow all types of foreign capital to come to India. The danger exists that 'in these swings of opinion ....detailed policy to be pursued might suffer from extreme pre-occupation with the exigencies of the moment'.[24]

Therefore, there is need for a long-term policy consistent with the planned and projected rate of growth of the Indian economy in the future. This will mean a policy towards foreign capital which is part and parcel of the over-all industrial policy and geared to the targets of perspective planning.

Once the need for regulating foreign investments is accepted, the objectives of any procedure that we have to adopt becomes clear. The insulation of the domestic economy from the destructive effects of foreign investments assumes a pivotal place in our national objective.

Regulation of foreign capital can assume any of the following forms: (1) comprehensive regulation affecting all foreign investments in general; and (2) selective regulation or regulation of foreign investments in particular sectors.

Practically in all recipient countries, comprehensive regulation of one form or the other exists. In certain countries, the entry of foreign business interests is prohibited in certain well-defined fields of economic activity in the interests of national security or on the basis of any other non-economic criterion. Certain sectors considered to be of vital public interest such as transport and communications, coastal shipping, production of arms and ammunitions, etc., may be considered as prohibited areas for foreign capital. In the case of extractive industries, many governments have imposed regulations on foreign concerns mainly due to apprehensions that the vast natural resources of the country may fall into the hands of a few powerful foreign concerns. As the United Nations survey of foreign capital in Latin America has pointed out, 'the fact that the extraction of minerals and petroleum involves large installations, often under the control of a single enterprise, contributes to the con-

24. 'Problems of private foreign investment', *The Eastern Economist* (New Delhi) Blue Supplement, 1 November 1957, i.

cern over regulations'.[25]

The policy of insulating the domestic economy from the onslaught of foreign investments essentially involves the protection of existing indigenous industries from unfair and cut-throat competition from the foreign firms. In many recipient countries, the need for protecting the indigenous industries is a major factor influencing the entry and authorisation of foreign enterprise.[26]

On a practical plane, 'selective screening' may pose a number of administrative problems. However, once it is realised that unconditional influx of foreign capital is an undesirable phenomenon, the formulation of procedures for implementation is only a matter concerning details. It is highly desirable that a unified, and at the same time simplified, procedure is adopted for screening the various proposals for the investment of foreign capital.

It is clear from earlier discussions that the contribution of foreign investments to the Indian economy can be assessed only by a detailed analysis of the costs and benefits of particular investment projects. The variations in the cost and benefits of particular investments suggest that a truly national policy towards foreign capital should be based on the principle of 'discriminating admittance'. Those forms of foreign capital which bestow a net benefit on the Indian economy are to be encouraged while those which inflict a net cost to the economy should be avoided or discouraged.

A policy of discriminating admittance, to be operationally valid, should be based on a 'scale of preference'. Such a

25. United Nations, *Foreign Capital in Latin America* (New York, 1955) 18.

26. For example, such a provision exists in Chile. The resolution passed by the Economic and Social Council of the United Nations in April 1954 (Resolution 512B ZXVII) also stresses this point. Again, the resolution passed at the 10th Inter-American Conference of the Organization of American States held in March 1954 in Caracas stated as follows:

> That in order for new foreign investment to be an effective contribution to the economic development of the American countries, it is desirable to take into account, among other things, the situation with regard to previously established enterprises so as not to affect their normal development, provided it is in harmony with the national interest. —*Resolution of 19 March 1954 (Document 512).*

scale of preference can be drawn up only if we have a detailed knowledge of the costs and benefits of particular investments. Proposals for the investment of foreign capital in particular fields can be put on the lower or the upper level of the scale according as the net cost is greater or smaller or the net benefit is smaller or greater.

The general principles which should guide the process of screening foreign capital need little elaboration. Subject to the general criteria already enunciated in the preceding pages, entry and authorisation may be given to foreign capital in the following spheres: (1) where new lines of production have to be started; (2) where domestic production is inadequate to meet total demand[27]; and (3) where technical know-how and managerial expertise can be secured only with the import of capital.

In all these cases, however, a number of conditions have to be satisfied by the foreign firm concerned. Firstly, there must be a well-conceived programme of manufacture. Second, it should contribute to the foreign exchange earnings of the country; at least it should not result in any net drain on foreign exchange. Third, the plant should be relatively efficient to be able to contribute to a substantial increase in production. Fourth, it should have a programme of imparting technical and managerial skill to Indians and should effect the progressive Indianisation of the working force.[28]

27. In India, in the past, foreign capital was allowed to enter into fields where indigenous industries had sufficient production capacity to meet the demand. Mention should be made of industries such as soap, sewing machines, biscuits and chocolates. About this phenomenon, the evidence before the Fiscal Commission of 1949-50 had shown that 'our Government have ignored indigenous interests, and are permitting foreign interests to set up their own factories in the very fields in which the indigenous production is either already sufficient or can be easily stepped up to meet the country's full demands' (*Report of the Fiscal Commission, 1949-50*, III, 121, Evidence).

It is this mistake that we should seek to avoid in the future.

28. It will be interesting to note that the minority opinion of the Fiscal Commission of 1923 had suggested three conditions for the entry of foreign capital into the manufacturing industries, of which the last two relevant suggestions were: '(2) that there should be a reasonable proportion of Indian directors on the Board, (3) that reasonable facilities should be offered for the training of Indian apprentices' (*Report of the Fiscal Commission, 1923*).

Fifth, it should aim at increasing participation with Indian capital.

Repatriation of Income and Capital

Income transfers such as transfers of interest, dividends, wages and salaries, after taxation, are freely allowed in India. Nor are foreign companies subjected to any amount of discriminatory treatment in the matter of earning profits in India. Both Indian and non-Indian companies are governed by common regulations regarding the realisation of profits. This was made clear by the Indian Prime Minister's statement in the Constituent Assembly on 6 April 1949. He gave the assurance that 'foreign interests would be permitted to earn profits subject only to regulations common to all'.[29]

The Government of India's policy in this respect has been influenced by the conservative and customary notion about how to attract foreign capital. Foreign private capital, it is argued, can be attracted only by giving clear-cut assurances about the transfer abroad of their investment income. The Government of India 'recognises that foreign capital can only come to India on the basis of profit and safety for the investor'.[30] The Finance Minister argued in the Lok Sabha on 20 December 1954 that once the need for attracting foreign capital is accepted, 'we cannot obviously place any restriction in the matter of remittances of profits earned by foreign companies'.[31] Such a policy is not properly dictated by the needs of the national economy. A policy of encouraging foreign capital can coexist with a policy of reasonable restrictions of profit transfers. Moreover, the policy of restrictions could be wisely implemented in order to discourage those types of foreign capital which inflict a net cost to the Indian economy. The government's policy regarding

29. Prime Minister's statement in the Constituent Assembly, April 1949, *Constituent Assembly of India (Legislative) Debates*, II, IV, 1, 2386.
30. *Ibid.*, 2386.
31. C. D. Deshmukh's statement in the Lok Sabha, 20 December 1954, *Lok Sabha Debates*, II, IX, 28, 3477.

investment income transfers has been blind to the differences in the nature of foreign investments, the variations in the cost and benefits of particular investments, and the need for encouraging certain types of foreign investments and discouraging certain other types.

Suggestions that India should impose restrictions on the remittances abroad of profits of the foreign companies have repeatedly been made during discussions in the Parliament. Suggestions have been made that foreign companies should be required by law to plough back certain percentage of the profits into the company's investments in India. There have also been suggestions to freeze the entire profits of foreign enterprises in India. The Finance Minister in his statement in the Lok Sabha on 20 December 1954 could not see any wisdom in these suggestions. He pointed out that this 'amounts to restricting remittances of profits which is against our declared policy and, what is more, which is likely in fact to produce the contrary effect'.[32] Further, in his speech in the Lok Sabha on 26 May 1956 deprecating the suggestions for curtailing the foreign remittances and for taking compulsory loans out of profits and dividends of foreign companies, the Finance Minister stated that all measures aimed at restricting the remittances of profits and dividends would amount to cutting 'the thread of any kind of international intercourse such as we are familiar with in our international monetary organisations'.[33] He continued:

> We cannot belong to the International Monetary Fund and the International Bank for Reconstruction and Development and follow this method of stopping all foreign remittances of dividends and profits and taking compulsory loans from foreigners . . . . But supposing we were to break the code of conduct which is incumbent on the members of these organisations, then we have no right to count for loans from the international institutions.[34]

For the government, the main reasons for not imposing any restrictions on the transfer of investment income are:

32. *Ibid.*, II, IX, 28, 3477.
33. *Ibid.*, II, V, 73, 9602-3.
34. *Ibid.*, 9602-3.

(1) the need for attracting more and more private foreign capital into India, and (2) the desire on the part of the government to stick to the code of conduct incumbent on India as a member of the international institutions such as the International Monetary Fund and the International Bank for Reconstruction and Development. Surprisingly enough, no consideration of costs and benefits and the question of national advantage seem to have received any attention of the government.

Remittances of investment income has, of course, to be made only after paying taxes imposed by the Central and State governments concerned. 'Foreign concerns operating in India are allowed to remit their profits in full to their Head Offices provided that adequate provisions are made for payment of taxes'.[35]

Again, in the matter of remitting profits and dividends abroad, there is no discrimination between capital belonging to soft currency areas and that belonging to hard currency areas. While it is advantageous to the Indian economy to make a distinction between the hard and soft currency areas and to frame a discriminatory policy for transfer facilities, the government appears to be against such a policy. Assurances about a non-discriminatory policy were given by the Finance Minister in the Lok Sabha on the 20 December 1954. He stated that 'Under the present regulations, for very good reasons, profits of foreign business concerns are allowed to be remitted freely, irrespective of whether the foreign company belongs to the soft currency area or the hard currency area'.[36] In general, the government policy has been to put no limitations at all on the remittance of profits and dividends. The statement of the Director-General of Industries and Supplies, Government of India, in October 1949, that the 'Government do not foresee any difficulty' in continuing the existing facilities for remittance of profits to the home country' still holds true

35. Economic Adviser to the Government of India, *Governmental Measures Affecting Foreign Investment in India* (1950) 17.

36. C. D. Deshmukh's statement in the Lok Sabha, 20 December 1954, *Lok Sabha Debates*, II, IX, 28, 3477.

as an axiom of government's policy'.[37]

We have seen that income transfers such as transfers of profits, dividends, interest and royalties after taxation are freely allowed in India. Reasonable annual remittances out of service income such as wages and salaries are also freely allowed. On retirement, the accumulated savings can be freely transferred abroad.

While income transfers are almost freely allowed, capital transfers are subject to certain amount of control. There is no restriction on loan repayments which are made according to contract. On the sale or liquidation of business, the repatriation of foreign capital is also permitted. All capital investment which have been previously approved and registered have the right to be repatriated. But special permission is necessary in the case of all other investments.

Up to 1950, even though there were no limitations on the repatriation of capital by non-residents to the Sterling area countries, repatriation to non-Sterling area countries was subject to control. The position in regard to capital transfers changed considerably since 1950. As a result of relaxation of controls effected by the Government of India, investments in approved projects made by residents of non-Sterling area countries after 1 January 1950, have been declared eligible for repatriation at any time. In a Press Note issued by the government in June 1950, which contained the principles that will govern the repatriation of foreign capital by non-residents, it was stated that residents of Sterling area and Norway, Sweden and Denmark will be permitted to freely repatriate their capital invested in India. With regard to residents of other countries; the Press Note announced the following relaxations of control:

(i) Capital invested after 1 January 1950 in projects approved by the Government of India may be repatriated at any time thereafter to the extent of the original investment and from the proceeds of the investment.

(ii) Any part of the profits derived from investments and

37. N. 11, 12.

ploughed back into projects with the approval of the Government of India may be treated as investment for the purpose of permitting repatriation.

(iii) Appreciation of any capital invested under (i) and (ii) above would not qualify for repatriation and the amount available for repatriation will be restricted to the amount of rupees originally invested or ploughed back. In the case of investment by means of goods and services, the amount will be the rupee value of such goods or services as recorded in the books of the company or firm concerned at the time of investment.

(iv) Such repatriation facilities would not apply to purchase of shares on the stock exchange unless it is an integral part of an approved investment project.

(v) The above repatriation facilities would not apply to capital in India before the 1st January 1950.[38]

It should be noted that unlike in many countries where no special provision is made regarding the transfer of capital gains, in India, express provision has been made permitting capital appreciation to be repatriated.

Applications for repatriation of capital, as in the case of applications for investment of foreign capital in India, have to be made to the Reserve Bank of India who will refer them to the Government of India and obtain their orders. Even in the case of a company which is not owned or controlled by non-residents, all payments due to residents of foreign countries must get the prior approval of the Reserve Bank of India. The major consideration for permitting the repatriation of foreign capital is the exchange position of the country. Unlike in the case of income transfers where India, as a member of the International Monetary Fund, is bound by the code of conduct of the organisation not to impose any restriction, in the case of capital transfers we are permitted to impose regulation in the interests of exchange stability.

38. Press Note issued by the Government of India, June 1950, reproduced in *India Invites Foreign Capital,* 15-16.

In his statement in the Constituent Assembly on 6 April 1949, the Indian Prime Minister had stated:

> We do not foresee any difficulty in continuing existing facilities for remittance of profits, and the Government have no intention to place any restriction on withdrawal of foreign capital investments, but remittance facilities would naturally depend on foreign exchange considerations. If, however, any foreign concerns came to be acquired, Government would provide reasonable facilities for the remittance of proceeds.[39]

It is clear, therefore, that in their enthusiasm to attract foreign capital, the government have permitted the repatriation of foreign capital and income without any serious regulation.

It may be possible to condone the government's conservative approach to investment income transfers and repatriation of capital in periods when our balance of payments is not subject to severe strain. But the insistence upon a policy of absolute freedom for profit transfers and maximum facilities for repatriation cannot be in our national interest in periods of severe exchange difficulties. In fact, during the days of foreign exchange crisis the government's policy pronouncements were tested and found sufficiently conservative by the foreign business interests. As George Rosen admits:

> In fact, in one or two cases during the past year, when there has been a serious foreign exchange crisis, American firms have deliberately tested the Government's willingness to permit convertibility and the Government has allowed repatriation very quickly[40]

Policies and Measures Regarding Operational Aspects

Policies and measures regarding operational aspects relate mainly to two questions: (1) division of ownership between foreigners and nationals, (2) employment and training of nations.

Government's policy in regard to these operational aspects

39. *Constituent Assembly of India (Legislative) Debates*, II, 1, 23806.
40. George Rosen, in *American Trade with Asia and the Far East* (Ed. Baur) 132.

was made clear in the Industrial Policy Resolution of 6 April 1948, which stated:

> .... as a rule, the major interest in ownership and effective control should always be in Indian hands; but power will be taken to deal with exceptional cases in a manner calculated to serve the national interest. In all cases, however, the training of suitable Indian personnel for the purpose of eventually replacing foreign exports will be insisted upon.[41]

(i) *Ownership and control.* The share in ownership and control to be allowed to foreign interests in industrial enterprises in India is to be decided upon, from time to time, according to the merits of the case. After the Industrial Policy Resolution was formulated, the government thought it necessary to 'evolve a scheme whereby, when a company is functioning in India with foreign capital, the major interest in ownership and effective control remain in Indian hands.'[42] The participation of Indian capital is legally insisted upon in the case of certain industries. For example, the Petroleum Concession Rules, 1949, framed under the Mines and Minerals (Regulation and Development) Act, 1948, provides that in the case of an alien or a company incorporated outside India, the government may require the licencee or lessee to associate Indian capital in the enterprise to such extent as may be agreed upon between him and the government. The guiding rule in such cases is to make provision for 51 per cent Indian and 49 per cent foreign capital.

But there are cases where the agreement entered into by the Government of India with foreign concerns for the errection of oil refineries in India, provided for only a minority share for domestic capital. The Finance Minister pointed out in Parliament that in one case provision was made only

41. Statement on Industrial Policy laid on the table of the Constituent Assembly, 6 April 1948, by Shyama Prasad Mookerjee, Minister of Industry and Supply, *Constituent Assembly of India (Legislative) Debates*, II, V, 1, 3296-7.

42. Shyama Prasad Mookerjee's statement in the Constituent Assembly, 7 April 1948, *Constituent Assembly of India (Legislative) Debates*, II, V, 2, 3394.

for an investment of 25 per cent Indian capital. Moreover, the 25 per cent of the investment which was open for Indian subscription was only in the form of cumulative preferential shares with no voting rights. In another case, there was provision for the investment of Indian capital only up to an amount of Rs. 2 to Rs. 3 crores. Commenting on the reasons for entering into such agreements providing for minority Indian share, the Finance Minister observed that 'in the circumstances in which India was placed at present, namely, shortage of capital, the Government thought that nothing was lost from the practical point of view by this proportion, although the guiding rule in such cases was 49 per cent foreign and 51 per cent Indian.'[43] He doubted whether even the amounts provided for Indian subscription would be forthcoming. He further remarked, 'if we find at any time, contrary to my expectation, that we have a great deal of surplus capital, it would be possible for us to take up the matter with these companies and some others; we shall then persuade them to open out a part of their capital for Indian investment'.[44]

This pragmatic approach set in motion in 1952—an approach which condoned any deviation from the declared policy in the name of 'nothing being lost from the practical point of view'—when taken to its logical end could only result in virtual abandonment of the basic policy. This is precisely the picture which obtained in 1960. The US journal *Business International* had to say:

> Anything is possible—including approvals of wholly or majority foreign-owned investments—in India's long, often exasperating, but always pragmatic—approval procedure . . . . Numerous majority positions have been okayed in recent months, despite the basic and oft-repeated policy of favouring foreign minorities: 9 in 1960, 14 in 1961, and 28 in 1962.[45]

During 1962-3, American firms continued to make a clear dent into Indian business with a series of majority appro-

43. C. D. Deshmukh's statement in Parliament, July 1952.
44. *Ibid.*
45. *Business International,* 13 December 1963.

vals, as can be seen from the following table:

Table 62

FOREIGN MAJORITY APPROVALS IN INDIA, 1962-3

Foreign investor	*Country*	*Paid-in equity ($000)*	*% majority held*	
American Gage	U.S.	2,100	100	instruments
English Electric	U.K.	1,260	58.5	n.a.
Frick Co.	U.S.	500	51	refrigeration
McNally Pittsburgh	U.S.	1,000	60	coal-washing
International Computors	U.K.	1,000	60	data equipment
Molins Machine	U.K.	714	51	n.a.
Rohm & Haas	U.S.	840	57	fungicides
Sandvikens	Sweden	1,260	60	tungsten carbides
S. F. Products*	Sweden	262	60	fans, blowers
SKF/Skefko	Sweden	8,400	60	machinery
United Shoe	U.K.	840	53	tacks
Victor Mfg.	U.S.	250	55	gaskets

Loal firm name.

The strategy employed by American firms to obtain majority approvals has been to offer certain ostensibly advantageous conditions in return for a majority equity share. *Business International* reported:

> International Computors and Tabulators (ICT) for example, came up with such an attractive package that New Delhi could not say No to its request for 60% of the equity. Its products are by nature highly technical. It will sell the entire remaining equity to the public. Its equity contribution will fully cover the project's $ 525,000 foreign exchange requirements (though ICT will get some equity for know-how also). Its ace-in-the-hole for the balance of payments officials was an offer to begin exporting the very first year, and to earmark a handsome 30% for export when full production is reached.[46]

Again, under the caption, 'Should Auld Acquaintance Be Forgot?' *Business International* wrote:

> On the other hand, Frick Co. of Waynesboro, Pa, has just gotten the green light for a 51% position in a $ 500,000 venture, 10% of it being for initial and continuing know-how contributions. It gets a royalty on sales to boot. Frick

46. *Ibid.*

agreed to sell 24.5% of the total equity to the public reserving the remaining 24.5% for its long-term distributor, a small Indian businessman. It did not have to promise to export. Its favoured treatment was undoubtedly in recognition of its successful 50-year history of participation in the growth of the local aid-conditioning and refrigeration industry.[47]

As a criterion for the division of ownership and effective control between residents and non-residents in an industrial undertaking, the government have not adopted any precise rule. In the absence of well-defined criteria for determining majority or minority share capital for foreign investors, there have been, over the last decade, too many exceptions to the general rule implied in the governments' industrial policy resolutions.

(ii) *Employment and training of Indian nationals.* The policy of the Government of India regarding the question of employment and training of Indian nationals in foreign enterprises in India, was made clear in the Industrial Policy Resolution of 1948 which stated that 'the training of suitable Indian personnel for the purpose of eventually replacing foreign exports will be insited upon'.[48] The declared policy is to insist upon the progressive Indianisation of employment in all foreign concerns. The employment of non-Indians in posts requiring technical skill and experience is not objected to by the Government of India if Indians with the necessary qualifications and technical skill are not available. This is considered only as a temporary measure. Foreign concerns are required to train Indians in all processes which involve technical skill with a view to replacing foreigners by Indian hands at the earliest time Possible. The government attach 'vital importance to the training and employment of Indians even for such posts in the quickest possible manner'.[49]

47. *Ibid.*

48. Statement Industrial Policy laid on the table of the Constituent Assembly, 6 April 1948, *Constituent Assembly of India (Legislative) Debates*, II, V, 1, 3296-7.

49. Prime Minister's statement in the Constituent Assembly, 6 April 1949, *Constituent Assembly of India (Legislative) Debates*, II, IV, 1, 2386.

In practice, however, the objective of progressive Indianisation has not been achieved in any creditable manner. It is true that in many agreements made with foreign concerns for the establishment of industries in India, express provision is made for the training of Indian nationals either in the farctories in India or abroad. In certain cases, the employment of a substantial percentage of Indians in the industry both for skilled and unskilled jobs is insisted upon. For example, the agreements arrived at between Brush Aboe (Associated British Oil Engines Group) and Kirloskar Oil Engines Ltd., Poona, and Kirloskar Electric Co. Ltd., Bangalore, for the manufacture of diesel engines and electric motors, 'provide for training of Indian technicians in the works of Petters-Stanes (London) and Brush Electrical Manufacturing Co. Ltd. (Lough Borough).[50]

In the case of petroleum concessions, the government have introduced rules which insist on the employment and training of nations. Under the Petroleum Concession Rules, 1949, the government may require the licencee or lessee to employ Indian citizens at all levels.[51] The extent of employment facilities to be given to Indian nationals depends upon the provisions made by mutual agreement. Arrangements for the training of nationals in India and abroad are also insisted upon according to the Rules.

In the field of key industries of an all-India import, which are subject to greater control and regulation, the Government insist upon the training and employment of nationals. Even though there have been demands from Indian industrialists to have 'technical autonomy' in our key industries, in the opinion of the government, there is need for importing foreign technical know-how since indigenous technical knowledge has not yet grown to the desired extent. Therefore, in the opinion of the government, collaboration with foreign firms is necessary in the key industries. The objective of such collaboration is supposed to be the training of

50. Reply to question in Parliament, 5 February 1951, by the Minister for Commerce and Industry, *Parliamentary Debates*, II, VI, 1.

51. Petroleum Concession Rules, 1949, framed under the Mines and Minerals (Regulation and Development) Act, 1948.

our nationals at the earliest time possible so that they may replace the foreign personnel employed in the beginning. Explaining governmental policy regarding the question of technical autonomy in our key industries, the Minister of Production, K. C. Reddy, stated:

> Whenever the Government of India has decided to come into collaboration with foreign firms, it has been with a view to obtain technical know-how, in the matter of the building up of these industries, and not for any other reason. If the Government realised and found that there was enough technical competence in our country to build up factories of the kind we are building up with foreign technical collaboration, then certainly, Government would have depended on indigenous scientific and technical personnel. That is why in almost all the agreements which the Government of India have entered into, in respect of the establishment of some of these industries, care has been taken to see that foreign collaborators who come in are made responsible for training Indian personnel to take the place of the foreign personnel, as early as possible[52]

Foreign participation in industrial projects in India is allowed under certain conditions which, in most cases, include provisions that

> the major interest in ownership and effective control in such companies would be in the hands of Indians; Indians would be trained in the respective industries at their principal factories in India or abroad; . . . the foreign participation should fully co-operate with the Indian firms in giving them technical assistance[53]

Thus, the declared policy of the government with regard to operational aspects can be summarised as one which insists on the absorption of benefits in the form of technical skill and employment by Indian nationals. The divergence between the declared objective and the actual performance is, however, the disturbing fact in this connection.

52. Minister of Production K. C. Reddy's reply to debate in Parliament, 9 April 1954, *Parliamentary Debates (House of the People)* II, III, 42, 4516.
53. *Parliamentary Debates*, I, VII, 2, 2844

Taxation Policy

Taxation policy in India has been characterised by many economists as a deterrent affecting foreign investments in India. The foreign concerns in India have, for a long time, raised objections to the tax structure in India. The opinion of the business community has been generally against the tax structure in India, particularly its 'effect upon investment sentiment', which in their opinion, 'encourages disinvestment and acts as a deterrent to new commitments by the foreign investor.'[54] It was in response to these sentiments voiced by the foreign investors and the business community in general that the government announced, from time to time, certain concessions to foreign residents doing business in India.

The important questions regarding the tax structure in India, which are of direct interest to the foreign investors, relate to (a) taxation of income of non-residents and corporations, (b) taxation of dividends (including inter-corporate dividends, (c) arrangements for double taxation relief, and (d) other tax concessions and reliefs.

While taxation of income of residents is made on their global income (with tax rebate in case of income originating in foreign country with whom India has no double taxation relief arrangement), non-resident individuals and entities are taxed on their local income (income originating or received in India), but at rates appropriate to their global income. Non-resident corporations will be taxed on their global income if more than half their total income is derived from India. Even both individuals and corporations are taxed, the government have taken measures to avoid double taxation atleast to a certain extent. The shareholder is given credit for the income-tax paid by the corporation.

The Indian Income-tax Act had granted exemption from tax on salaries earned by foreign 'technicians' in India during the first 365 days of their arrival in India. This period of tax holiday to foreign technicians was then extended

54. 'Taxation and foreign investment', *Capital* (Calcutta) 3 May 1951, 614.

to the first three years of their service in India. A technician is defined as a 'person having specialised knowledge and experience in constructional or manufacturing operations, or in mining, or in the operation or distribution of electricity or any other form of power, or industrial or business management techniques, who is employed in India in a capacity in which such specialised knowledge and experience are actually utilised.'

There have been suggestions from different quarters to widen the meaning of the term 'technician' to include foreign managerial personnel and consultants.[55] Arguments have also been advanced in favour of further extending the tax holiday. But, considering the high level of personal income and salaries received by the foreign technicians, the further extension of the period will not only be unnecessary, but discriminatory to Indian personnel.[56]

The reasons for a preferential tax rate on foreign investments do not seem to be quite convincing. It is not likely that such a reduction in tax rate will substantially increase the rate of capital inflow into India. Moreover, the cost to government revenue which will result from any reduction in tax may outweigh the probable incentive effect on foreign investment.[57]

55. 'The Taxation of Foreign Personnel', *The Eastern Economist*, 1 November 1957, Blue Supplement, iv.

See also, National Council of Applied Economic Research, *Taxation and Foreign Investments* (Bombay, 1957) 14.

56. The advocates of a policy of tax concessions as a major stimulant to the inflow of foreign capital, often go to the extreme of imposing a discriminatory tax system in favour of non-residents. *The Eastern Economist*, for example, argues that

> ...generous concessions will need to be applied to foreign personnel even if they are not provided to Indian executives. There is justification enough for this discrimination, because foreign personnel have generally to maintain two establishments, and need to make provision for the education of their children.

57. The National Council of Applied Economic Research does not accept this view. After making a series of recommendations regarding tax concessions to favour foreign investments, the Council argues that 'The recommendations made in this report, if implemented, may lead initially to some loss of revenue. It is our firm belief that, on balance and over a period of time, the action taken will be justified by an increased flow of foreign investment'.—National Council of Applied Economic Research, *Taxation and Foreign Investment*, 2.

Dividends paid to non-resident shareholders are separately taxed in India, and it is in the form of a graduation based on the dividend rate.

Taxes on companies are composed of (1) income-tax at the maximum rate and (2) super-tax (or corporation tax). Income tax is charged at the same rate on all companies irrespective of the differences in their organisation and structure. Organisationally, we can classify foreign companies into (1) branches, (2) subsidiaries, and (3) Indian companies with minority share-holding. The rate of super-tax differs from one another, from one form of company to another. The incidence of taxation on the three different forms of foreign firms can be seen from the following table which shows the percentage of retained profits after taxes depending on the dividend rate declared.[58]

Table 63

Net profits wholly used to distribute following dividend rate	*Retained profits (percentage)*		
	Branch	*Subsidiary*	*Minority share-holding*
0% (i.e. profits placed in reserve)	37.8	56.6	56.6
6%	37.8	41.0	29.0
10%	37.8	39.0	27.5
18%	37.8	36.0	25.5
25%	37.8	34.2	24.3

From the above table it is clear that the impact of company taxes on foreign investments is in favour of subsidiaries more than branches and branches more than minority share-holdings. A policy of differential rates is conducive to the channellisation of foreign capital into forms of company organisation which a recipient country prefers. But the differential rates in India seem to be imposed in the wrong manner. It would have been more advantageous to the Indian economy in terms of cost and benefit if the differential rates were designed to encourage the inflow of foreign capital in the form of minority share-holdings.

58. National Council of Applied Economic Research, *Taxation and Foreign Investment*, 44.

Apart from the differences in super-tax according to the organisational form of the companies, differential rates exist in respect to certain conditions which the companies may fulfil. These conditions include questions as to whether the prescribed arrangements for the declaration and payment of dividends in India have been made, whether the company has distributed bonus shares and whether it has distributed dividends in excess of 6 per cent of its paid-up capital. Such conditions are, however, considered necessary by the government in order to ensure the interests of the shareholders. Section 23A of the Indian Income Tax Act provides that if a company in which the public are not substantially interested, distributes less than the prescribed percentage as dividends, the company will be subjected to a penal super-tax.[59] The Section also gives the criterion by which the distinction as to whether a company is one in which the puplic are interested or not, is to be made. This might serve as a disincentive to foreign investors to invest their capital in those fields where Section 23A would apply. But it would serve as an indirect factor influencing the channellisation of foreign investments into those fields where the public are substantially interested.

The Indian Finance Act, 1951, made certain new provisions which are of direct interest to non-resident shareholders. Clause 3 of the Finance Act, 1951, provided that all non-resident share-holders would be taxed in India on their Indian income at the rate of 4 annas in the rupee income-tax and 3 annas in the rupee super-tax plus 5 per cent surcharge, unless they exercised an option to be taxed at the rate applicable to their global income.

The need for avoiding double taxation has been a primary concern of the government. The Government of India have entered into agreements with a few countries like the U.S.A., Pakistan and Ceylon for the avoidance of double taxation of income. In the absence of any such agreement with other countires, the same income of the foreign investor is taxed in India where the income originates, and also by the in-

59. Indian Income-Tax Act, Section 23.

vestor's home country. This, the foreign investors have often argued, is one of the obstacles to the increased inflow of foreign private capital into India. Double taxation relief is given in the form of tax credits on the twice taxed income.

The agreement between India and the United States with regard to double taxation shows how, in effect, double taxation is avoided. According to the Indian Income-tax Act, an American national who is not a resident of India is liable to the maximum rate of income tax on his income accruing, arising or received in India. But super-tax is charged by taking into account the rate of income-tax payable on his global income. Under Section 131 of the Internal Revenue Code of the U. S. Law, the U. S. national who has been taxed in India will be given full credit for the tax paid in India, thereby avoiding double taxation on the national's income. An American national who is a full-resident of India, as defined in Section 4A and 4B of the Indian Income-tax Act, is taxed on his global income calculated after deducting that part of his foreign income which is not remitted to India. But such reduction would not exceed Rs. 4,500.

In order to stimulate new investment in industries in India, the government have, from time to time, announced certain tax concessions and reliefs. In a communique issued by the government on October 1948, tax concessions relating to the following items were announced:

(a) liberalisation of rules relating to depreciation allowance for plant and machinery for income-tax purposes;

(b) exemption of new industrial undertakings from income-tax for a specified period, and

(c) relief in respect of customs duty on imports of raw materials and plant and machinery for industrial purposes.

In the government's communique dated 22 October 1948 further details regarding these concessions were given. The Indian Income-tax Act provides for relief from taxation by exempting for 5 consecutive assessment years, the income of a newly established industrial enterprise, as does not

exceed 6 per cent of the capital invested in the undertaking.[60] In addition to this, development rebate of 20 per cent of the cost of newly installed plant or machinery (35 per cent in the case of coal mining machinery) in respect of the year of its installation is also provided.[61] Another important tax concession is in the form of allowing greater depreciation allowances for tax purposes. Depreciation is permitted for an initial period of 5 years at double the normal rate.

Tax proposals presented with the 1964-5 budget provided a number of tax concessions aimed at accelerating the inflow of private foreign capital. These concessions which encourage subsidiary holdings of foreign companies include (i) the removal of the Super-Profits Tax on corporations and the substitution, in its place, of a less onerous surtax on company profits, applicable to a smaller number of companies. (ii) reduction in taxes on all inter-corporate dividends to 25 per cent from the earlier rates ranging from 25 to 50 per cent, and (iii) reduction in the effective tax rate on technical services to 50 per cent (same as in the case of royalties) from the former rate of 63 per cent.

The tax concessions introduced by the budget of 1964-5 have been given in the expectation that it will encourage new foreign investments in Indian companies. It is part of the grand strategy of accelerating the inflow of private foreign capital through an 'open door' policy. However, experience shows that tax concessions have had little or no relation to the investment decisions of foreign companies and investors. Investment decisions of foreign investors are based on a number of complex factors out of which tax rate is only a minor one. It is possible that for foreign companies contemplating fresh investments in India tax reduction will be considered as an additional attraction. But it will not be the major reasoning for an investment decision.[62]

60. *Ibid.*, Section 15c.
61. *Ibid.*, Section 10(2)(vib).
62. Barlow and Wender who made a survey of the attitudes of U.S. companies towards foreign investment states:
We believe that tax incentives can only counteract the factors limiting investment by making companies more active in investigating opportuni-

Any change in tax policy vis-a-vis foreign investments, as we have already noted, must consider two aspects, namely, (1) the possible loss of governmental revenue and (2) the incentive effect on foreign investments. Moreover, any change in tax policy has to fit in with India's social and economic policies.[63] If in the process of giving expression to our social goals we have to frame a tax structure which directly or indirectly acts as a deterrent to foreign investments, it has little remedy. Our tax policy has been evolved in response to domestic problems and needs. Our major task is to raise domestic capital resources. In our efforts to stimulate domestic capital formation, we may have to frame certain tax laws which may adversely affect the possibility of raising capital resources from foreign private investors. If such a conflict arises, the obvious choice has to be made in favour of domestic capital because it is the basic structure on which the future developmental needs of the country have to be met.

The policies and measures pursued by the Government of India towards foreign capital sometimes exhibit complete lack of internal consistency. The burden of governmental policy, it is clear, is towards the encouragement of private foreign capital. Questions of national interest and national advantage are often repeated in policy pronouncements, but seldom adhered to. There seems to be no real attempt to coordinate the various measures under the dictates of an integrated policy based strictly on national interest.

The lack of internal consistency or the absence of coordination among the various measures directly relating to

ties. We do not believe that the added advantage which might be given through any tax measures would be effective in encouraging any substantial amount of investment where detailed investigation of a proposition has resulted in a decision against investment. — Barlow and Wender, *Foreign Investment and Taxation* (Englewood Cliffs, 1955) 217.

63. For example, in order to achieve planned economic development in India, to reduce inequalities in income and wealth, and to establish a socialist pattern of society in general, certain tax policies such as progressive taxation will have to be adopted. If it cannot be appreciated by the private foreign investor who believes in the virtues of the private enterprise economy, it cannot be helped.

foreign capital is a serious criticism in itself. But there is a further criticism which is equally serious in its implications. There is practically no coordination between the policy towards foreign capital and the policies in other fields. The efficacy of any aspect of national policy is to be judged not only by its internal consistency, but also by the degree of coordination between this particular policy and the policies pursued in other sectors.

The lack of integration between the various national policies in India can be illustrated with reference to the government's policy towards foreign capital and their policy towards protection of indigenous industries. The policy of protection is pursued in many countries to foster the growth of indigenous industries against the onslaught of large foreign firms with superior competitive power and monopolistic positions. But the policy of protection as applied in India has been, in practice (although not in theory), an indirect promoter of foreign capital investments in India.

The history of foreign investments in India clearly show that the foreign companies have been shrewd enough to circumvent the restrictions on their activity by opening subsidiaries in India as 'India Limiteds', registered in India. Under the disguise of 'India Limiteds', many foreign concerns have taken the full advantage of protection which should have actually gone to the domestic industries only. It was in the background of these facts that the National Planning Committee suggested that 'no industrial enterprise with foreign capital should be allowed to camouflage itself as Indian enterprise by registering in India, or by adding the word "India" after their normal style and title.'[64]

The policy of protection becomes impotent and ineffective if every encouragement is given to foreign concerns to offer 'cut-throat' competition to indigenous industries. The futility of a protective policy built on the basis of a simultaneous policy of encouragement to foreign monopolistic concerns in India was demonstrated by Alfred Chatterton early in 1902. He observed:

64. National Planning Committee, *Report on Industrial Finance*, 40-1.

> Protection would attract capital from abroad, and with the capitalist would come the technical expert and the trained organiser of modern industrial undertakings. Success would undoubtedly attend their efforts, and India would contribute labour and raw-materials. The educated Indian would play but a small part; and he would in course of time realise that the protective duties mainly served to enable Europeans to exploit the country.[65]

He further asserted that

> India does not want a protective tariff to enable an artificial industrial system to be created, the masters of which will be able to take toll of the earnings of the country, and establish a drain on its resources which will in the long run retard progress.[66]

Chatterton's observations in the early part of this century have been proved to be correct in the light of Indian economic history. Indian experience in protective policy clearly shows that there has been a considerable menace of foreign concerns squeezing the benefits of protection under the disguise of 'India Limiteds'. The capacity of these 'disguised' foreign concerns to offer cut-throat competition to the domestic industries was never taken into consideration by the government. The result was that a number of Indian concerns were driven to the wall.

Before the War, more than 20 per cent of the cotton textile industry was under the ownership and (or) control of the British. The share of British capital in the sugar, cement, matches and paper industries were also significant. In order to secure the advantage of protection, many of these foreign companies started their subsidiaries registered in India. Some of the important examples are the Liver Brothers in soap industry, Dunlop in rubber industry and the Imperial Chemicals. The cost which India had to incur in giving protection to many an industry was over Rs. 50 crores.[67] On the other hand, the major portion of the benefits of such protection were cunningly squeezed by the foreign concerns masquerading as 'India Limiteds'.

65. Alfred Chatterton, *Industrial Evolution of India,* 1912.
66. *Ibid.*
67. Ashoka Mehta, *The Heights of Simla* (1940) 8.

The Planning Advisory Board which was appointed in 1946 argued in their report that the intrusion of foreign business interests in Indian industry should not be permitted. While demarcating basic industries as a field where foreign capital should be avoided entirely, the Report stated:

> If foreign companies with their vast resources, technical and financial, are allowed to establish themselves in industry in the fields at present not covered by Indian enterprise, there is little chance of that enterprise being brought into existence at a future date.[68]

Let us consider whether the Government of India's policy of protection has been, in practice, consistent with the objective of minimising the cost of foreign investments. It can be seen that the cost which the Indian economy has incurred (through the replacement of indigenous industries) as a result of the protective policy could have been avoided or at least minimised if the government had pursued a strict policy consistent with India's national interest. As a matter of fact, the policies and actions of the government, in many cases, inflated the cost to the Indian economy. The Report of the Fiscal Commission, 1949-50, contains the following evidence:

> We understand that lately the Ministry of Industries and Supplies had been advocating the possibility of getting some foreign interests to come and establish a bigger unit for aluminium production in this country and to ignore the existing industry which had been struggling for existence from its very infancy.[69]

The government's policy of encouraging the inflow of private foreign capital and the national need for giving protection to infant Indian industries, it is clear, have not been integrated into a unified policy. The inconsistencies which have existed between these two have made the government's protective policy ineffective and has functioned in a manner

68. Government of India, *Report of the Advisory Planning Board* (1947) 17.

69. *Report of the Fiscal Commission, 1949-50*, II, 363. See the written evidence of the Aluminium Corporation of India Ltd.

which does not redound to the interests of the national economy.

The Government of India's policy towards private foreign investments has been sought to be justified by official spokesmen on the ground that it is based on the principle of non-discrimination between Indian and foreign concerns. But it is doubtful whether this principle of non-discrimination can, in all cases, be consistent with our objective of maximising national advantage.

A truly national policy aiming at maximum national advantage cannot treat foreign capital and domestic capital on identical terms. The rationale for discrimination between the foreign and domestic sectors of the economy is the inherent competitive superiority of the foreign sector over the domestic sector. The huge financial resources and technical capacity for cut-throat competition which the foreign investors possess demand a separate treatment for the foreign sector. It should be remembered that in the absence of a policy of reasonable discrimination, the small and infant indigenous industries in the domestic sector will be driven to the wall.

There is a strong case for a policy of 'reasonable discrimination' based on the following reasons: Firstly, the infant indigenous industries cannot withstand the monopolistic competition of the foreign sector. Secondly, the national objective of protecting the indigenous industries (as embodied in the recommendations of the Fiscal Commissions[70] and Tariff Boards) will be frustrated in the absence of a policy of discrimination.

It will be worthwhile to recall that the Advisory Planning Committee in their report released certain ideas which could form the basis of a national policy. The report observed:

> It seems to us preferable that the goods which the country cannot produce at present, but would be in a position to produce later on, should continue to be imported from other countries rather than that their local manufacture

70. *Ibid.*, 213-5. See also the *Report of the Fiscal Commission, 1925* and *1923*.

should be started or expanded by foreign firms. In the course of time it will be possible to restrict or discontinue foreign imports, but vested interests once created would be difficult to dislodge.[71]

The warning contained in this report is serious enough to attract our attention. It is to our national advantage to rely as far possible on trade rather than to rely on foreign firms on our soil. Once foreign investors gain control over the industries in India, it will be difficult to disentangle them.

Policy Regarding Nationalisation

On the question of nationalisation of foreign concerns, the policy of the Government of India has been influenced more by the foreign investors' interests and the government's own extra-enthusiasm to welcome private foreign capital rather than by considerations of national interest. In theory, no doubt, it does not preclude the right of the government to acquire any foreign concern if it is in the ultimate national interest. This right of the government is to be exercised with the utmost caution and restraint. In actual practice, therefore, the government's policy implies that nationalisation of foreign concerns is only a remote possibility. And in the event of nationalisation, compensation will be paid to the foreign interests on 'a fair and equitable basis'. As Prime Minister Nehru stated in the Constituent Assembly on the 6 April 1949, 'if and when foreign enterprises are compulsorily acquired, compensation will be paid on a fair and equitable basis.'[72]

The payment of compensation will also be accompanied by 'reasonable facilities for the remittance of proceeds'.[73] Speaking specifically about United States investments in India, the Prime Minister tried to dispel the fears of the American investors about the safety of their investments in the following words: 'In the remote event of nationalisation of certain industries, the American investor would

71. N. 68.
72. *Constituent Assembly of India (Legislative) Debates*, II, IV, 1, 2386.
73. N. 35, 7.

be compensated in dollars, if that is the currency used in the original investment'.[74]

The government's policy on the question of nationalisation has, however, undergone some crystallisation (if not revision) after their experience in planned development. A new factor was, probably, the realisation on the part of the government that nationalisation of certain sectors will be necessary for the successful implementation of the development programmes. The nationalisation of the Imperial Bank may be considered as an example in this connection. The division of the industrial economy into three categories and reservation of the first category (industries listed in Schedule A) for the public sector', as formulated in the Industrial Policy Resolution of 30 April 1956, also provided this crystallisation in government policy.[75]

Secondly, certain questions of practical importance arose. For example, it was found necessary that the general policy of giving compensation on a 'fair and equitable' basis was sufficiently vague to be of any practical use in policy decisions. Prolonged controversy was possible about what constitutes 'fair and equitable' compensation. These factors played their part in concretising governmental policy when the Constitutional Amendment of April, 1955, was passed, which stipulated that adequacy of compensation will not be subject to judicial review. In other words, this constitutional provision makes the determination of compensation in the event of nationalisation the prerogative of the Parliament and puts the entire question beyond the jurisdiction of the courts.

The analysis of the policies and measures affecting foreign investments in India, clearly indicates the need for a revision of such policies. While refusing to commit the mistake of blindly opposing every type of foreign capital inflow, we should be careful not to go to the other extreme of giving a blank cheque to these investments. An unconditional welcome to foreign capital in all its forms is an error which should strictly be avoided.

74. *New York Times*, 28 August 1949.
75. *Lok Sabha Debates*, II, IV, 54, 6690-8.

There is a strong case for the nationalisation of foreign tea plantations on economic grounds. The state's claims in this case are strengthened by the historical fact that the state played a very decisive role in the growth of tea plantations in India particularly in the early period.

As demonstrated in an earlier chapter, the transfer abroad of profits and dividends by the foreign tea plantations has serious foreign exchange implications. The alternative productivity of the foreign exchange sunk in the servicing of investment income apart, the high profit transfers involve a direct deduction on India's wealth. A national policy about foreign tea plantations, cannot be restricted to fiscal absorption of profits or limitation on profit transfers.[76] The foreign monopolistic element in the foreign tea planting industry in India and the cost to the Indian economy arising from high profit transfers abroad, it is fairly clear, indicates that a programme of nationalisation of foreign tea companies should be given high priority.

One of the strong considerations in advocating a policy of nationalisation of foreign plantations relates to the need for conserving national resources. It has been revealed by the Plantation Inquiry Commission that foreign planters have paid very little importance to conservation of resources, replanting, etc. The maximum useful life of certain varieties of tea plants such as the Manipuri or Burma kind is about 40 to 50 years.[77] If higher yields are to be obtained, replanting has to be done in places where vacancies arise due to the old age of tea bushes. About 44 per cent of the area covered by foreign tea plantations are under pre-1910 bushes, as compared to 22 per cent of the area under Indian plantations. These pre-1910 bushes have grown old and needs to be replaced by new plants. So far, foreign investors have

76. A forceful plea for retaining a part of the profits of foreign tea companies in India was made by M. K. Sinha: 'The Indian tea is principally a source of wealth of India, and it is proper that a share of the profits of the trade and industry are retained by India'. (M. K. Sinha, *Case for the Tea Industry and Trade*).

77. Tea Board, *Report and Recommendations of the Special Officer Appointed by the Late Central Tea Board for the Survey of Marginal Tea Gardens in Cachar and Tripura* (1954) 2.

given little attention to the question of replanting. M. S. Calderwood, Chairman, Planting Committee of the United Planters' Association of Southern India admitted in his address to the annual conference of the Association in August 1955, that 'a considerable acreage of tea is fast reaching a stage when it must either be replaced or re-planted.'[78] As K. G. Sivaswamy in his Minute of Dissent to the Report of the Plantation Inquiry Commission observed, 'From the national point of view, a strict control is necessary that land with tea bushes is not left vacant without replanting.'[79] While foreign investors have neglected the need for replanting, etc., they have lost no time in the payment of dividend out of reserves! 'Any payment made in terms of profits and dividends without making provision for continued conservation is tantamount to taking capital out of the country.'[80]

The lack of any systematic programme of replanting in the foreign tea plantations can be explained by the fact that the foreign investors are having only a short-term perspective about their continuance in the field. It seems that most of the foreign planters are awaiting a time when they will sell out their interests and repatriate their capital abroad. Their short-term considerations demand the payment of dividends out of reserves and the utter disregard to progress of replanting.[81]

The need for increasing efficiency and reducing costs in the plantation industry is also tied up with the question of nationalisation. The Plantation Inquiry Commission's report state that in the case of tea plantations in 1953, the Sterling companies had the highest costs amounting to Rs. 135.67 per 100 lbs, while the costs in the Indian companies

78. M. S. Calderwood, *A Survey of Plantation Affairs* (Coonoor, 1955) 2.

79. *Report of the Plantation Inquiry Commission, 1956*, I. See Minute of Dissent by K. G. Sivaswamy, 327.

80. *Ibid.*, 327.

81. The report of a special officer who surveyed tea gardens in Cachar and Tripura stated that in three marginal gardens, the British investors had not invested adequate money for the proper maintenance of the estates as 'they had been probably thinking of selling the estates for some time past before the dates of actual transfer' (N. 77; 15).

were comparatively less.[82]

The costs in the foreign companies were particularly high under what is called 'general charges'. Under this item is included the commission to managing agents. The general charges account for about 37 to 38 per cent of total costs. This item has shown a significant increase over the years. In Sterling companies the cost item under general charges increased by about 11 per cent in 1953 as compared to 1950.

It has been noted that in foreign plantations, there is a great degree of uneconomic capitalisation. The method of managing the estates is directly responsible for the present state of affairs. Foreign managers have resorted to a lot of over-capitalisation without a corresponding increase in production. Foreign plantations, left to their own, cannot possibly be expected to reduce the high costs which they incur at present. This is because foreign companies are organised on the basis of high profit incentives, and high commission for managing agencies is an integral part of their system. In addition, high brokerage and warehousing charges are characteristic of the foreign plantations. In other words, 'Most of the items of cost are built permanently into the cost structure'.[83]

If cost of production per unit of output can be considered as a barometer for measuring relative efficiency of different units in an industry, we can conclude, within the limits of a small margin of error, that foreign plantations, as constituted today, are less efficient compared to Indian plantations.[84] Nationalisation has to be considered as a first and

82. N. 79.

83. V. I. Chacko, 'A New Approach Needed to Save the Indian Tea Industry', *The Statesman* (Delhi) Tea Industry Supplement, 31 December 1958, 17.

84. Many have tried to maintain that foreign tea industry is the most efficiently operated industry in India. They base their argument on the fact that 'Gross profits as percentage of total capital employed are the highest in the tea industry than in any other industry.' See, for example, Srivastava, 'Tea as a Foreign Exchange Earner', *The Statesman* (Delhi) Tea Industry Supplement, 31 December 1958, 16.

Profits cannot be taken as a good index of efficiency in the tea industry particularly because profits are governed by external forces in the international market and because profits are often inflated by reducing expenditure on replanting, etc.

effective step in the complex of reorganisation of the plantation industry with a view to reducing costs and increasing efficiency.

The fear that immediate nationalisation of foreign plantations and the consequent transfer of managerial responsibility to Indian hands will reduce efficiency is unfounded. As the Plantation Inquiry Commission report has stated, 'the employment of Indian managerial staff may not bring about any change in existing managerial efficiency'.[85]

The major problem which India has to face in the event of nationalisation of tea plantations is the problem of the foreign market. The foreign investors have control not only over tea prduction in India, but also on the foreign trade of the product. Nationalisation can achieve only the isolation of the foreigners from the processes of production. With the entire mechanism of foreign trade still in the hands of the foreigners, India will have to face a serious problem of marketing the goods. Unless the problem of foreign market is also simultaneously solved, any programme of nationalisation is bound to fail.

The elasticity of demand for tea is not very significant. Price changes within a comparatively wide range may not bring about any pronounced change in demand. Tea, being one of the cheapest of beverages, is consumed by practically every section of people, including the low-income groups. The tea habit is firmly established. Therefore, any change in the price of tea is not likely to affect the demand for tea to any significant extent.[86]

If we probe into the fluctuations in the price of tea in the international market it will be revealed that the grip of foreign investors on the international market operations in tea is the key to the understanding of the problem. Today, the bulk of our tea goes to London for auctions where the British interests have complete control. The British con-

85. N. 79, I Tea.

86. The demand for tea is of course likely to go on increasing as world population increases and as the total income of tea consuming countries goes up. The income elasticity of demand is, however, not very significant as to make any intelligent guesses about future demand difficult.

trol both ends of the business, the production and the trade end. Production in India is tied to the market operations in Mincing Lane, London, making tea trade and industry a 'colonial affair'. Though Calcutta and Cochin have assumed increasing importance as centres of tea auctions, the organisation of the trade in these ports has again been linked, by and large, to London through the control of the British over trade agencies,[87] brokers and shipping companies. The Traders' Associations which control the trade in Calcutta are predominantly British and is constituted by British Agency Houses and planters with ownership and control over about 75 per cent of the industry.

Any programme of nationalisation of tea plantations will succeed only if the problem of the foreign market is solved. Nationalisation would mean not only removing British interests from the production of tea in India, but also forcing them out of the trade operations on Indian teas. Unless the Indian government, through the State Trading Corporation, or the Indian traders, through their creative enterprise, can immediately substitute the British trading interests and still maintain the market, the extinction of the British trading interests might result in the sudden collapse of our foreign market in tea. The seriousness of the situation will become clear if we take into account the growing competition from Ceylon and the 'low cost producers in Africa[88] and other countries'.[89] East African production of tea is today only about 7 per cent of the total production of India and Ceylon; but the rate of increase in East African production is astonishing and, considering its nearness to the Western market, East African tea is a "rising threat to Indian and Ceylon tea industry".[90] It is possible that the British interests who are

87. Some of the powerful agencies who have been functioning in the field are William Magor, James Finlay, Duncan Bros., Andrew Yule, Macneil Barry, Shaw Wallace, Planters Stores, Octavius, McLeod, and Oillanders Arbuthnot.

88. The East African countries which have assumed importance in recent years are Kenya, Uganda, Tanganyika, Nyasaland and Mozambique.

89. 'Keener Competition in Overseas Markets', *The Statesman* (Delhi), Tea Industry Supplement, 31 December 1958, 11.

90. N. 83.

displaced by nationalisation may invest their capital and expertise in new states in Ceylon and Africa and utilise all their present grip over the international trading operations in order to isolate Indian teas from the world market.[91]

The above problem can be solved only by starting a gradual and systematic programme of training Indian nationals in foreign trade operations in tea. In the field of tasting and blending of teas, training facilities have to be extended to Indians. The undue dependence on London for our export operations has to be eliminated. The Committee on Tea Auctions in 1955 stated in their report that 'It is our unanimous opinion that, for a variety of reasons, the enlargement of auction in India should not be postponed any further'.[92] The report continued, 'In our view . . . the immediate goal should be to impose a ceiling of 30 per cent of the total Indian crops as the quantity that can be exported for the purpose of auction. This should be reduced to 25 per cent by 1956-57'.[93] We may still maintain London as a trading centre for tea exports to the UK with sufficient control by Indians on the operations. In any case, Calcutta and Cochin have to be developed to handle the bulk of our tea exports. As M. K. Sinha pointed out,

> There is a natural inherent absurdity that a big paying industry that may secure much needed dollars and hard currencies shall be dominated by what is after all an alien group that must consider naturally its own interests. It is never safe that the purchasing power of India abroad shall be controlled by the trading policy of this group, if not by the UK. The Government will have to do what is necessary to get the trade and industry free.[94]

The liberation of Indian tea from British trading monopoly is, as we have already seen, an essential prerequisite of any

91. As a U.N. study has noted, investors in European metropolitan countries have already invested large sums in the plantation industry in Africa because they 'do not find Southeastern Asia as attractive a field for investment as in the past'. — United Nations, *International Flow of Private Capital, 1946-52* (New York, 1954) 33.
92. India, Ministry of Commerce and Industry, *Report of the Committee on Tea Auctions* (1955) 13.
93. *Ibid.*, 15.
94. N. 76, 10.

programme of nationalisation of tea plantations in India. An all-out effort to find new markets in countries other than traditional importing countries should be made. Countries such as Egypt, USSR[95] West Germany,[96] Eastern European countries could possibly become enlarged markets for Indian tea. A major step in this direction should be an attempt to produce new varieties of tea (black and bitter) in India which are popular in countries such as Egypt, Iraq, USSR and Eastern European countries. Intensive research, as is being conducted in the USSR for the production of new varieties of tea which 'combine yield with quality' [97] should be initiated in India, possibly under the auspices of the Government of India.

Coupled with a programme for diversification of our foreign trade in tea, geographically and in the varieties produced, a serious attempt to widen our domestic market should be made. With the increase in population and income in India, domestic consumption of tea has been increasing all the time. From 90 million lbs in 1938 to about 200 million lbs in recent years is, of course, not an unimpressive growth. As the FOA reports, 'the producing nations of Asia are drinking more and more of their own products'.[98] With the 2 per cent increase in India's population and with concerted efforts to popularise tea drinking, it is possible to increase the domestic consumption of tea to an extent necessary to deplete the off-take of India's tea produce. The development of the domestic market will, to a certain extent, reduce India's undue dependence on foreign market and will thereby

95. The President of the Calcutta Tea Merchants' Association has stated that there is scope for an appreciable increase of tea exports from India to the USSR. Further, as the leader of the Soviet Tea Delegation stated in Calcutta, 'people in the USSR were satisfied with the quality of Indian tea'. If the State Trading Corporation of India is vigorous enough to explore this new market, there is no reason why India cannot find a stable market for tea in the USSR and other socialist countries.

96. According to Dr. A. Seifriz, 'there is immense potentiality for popularising Indian tea in West Germany'.—See article on 'All Out Efforts to Promote Exports', *The Statesman*, Tea Industry Supplement, 31 December 1958, 19.

97. 'Keener Competition in Overseas Markets', *The Statesman*, 31 December 1958, 18.

98. *F.A.O. Bulletin*, May 1958.

reduce the vulnerability of Indian tea to fluctuations in the world market.

The policy in the field of petroleum must be one of strengthening the national petroleum industry in the public sector and thus reducing the monopolistic position of foreign petroleum companies. This has to be supplemented by effective measures to control and direct the existing private foreign companies in tune with national policies.

Control over the foreign companies in the petroleum sector involves a number of difficult problems. One such problem refers to the transfer abroad of profits and the repatriation of capital. Another question relates to the price which the subsidiary or branch companies in India pay for the crude oil they buy from their parent companies and associates. Because of special conditions in this industry and because of the existing relationships between the companies or branches working in India and their strong parents abroad, the foreign petroleum sector in India has a much higher capacity to conceal many aspects of their actual operation and thus evade or circumvent many of the rules and regulations of the Government of India.

Despite a policy of enlightened national interest followed by the Ministry of Mines and Oil for a continuous period up to the beginning of 1963, at no time did a properly worked out and integrated oil policy get implemented in India. The essential ingredient of governmental policy, as can be judged from policy pronouncements from time to time, has been the continuous strengthening of the public sector in order to contain and limit the monopolistic control of the private foreign interests on our oil industry and trade. However, this basic element in declared policy has been diluted very often with qualified support and encouragement to private foreign industry to such an extent that the foreign companies could decisively undermine our national interests.

The Industrial Policy Resolution of 1956 laid down that the development of the oil industry in India will be in the public sector. At the same time, the Resolution envisaged that collaboration with private foreign interests would be

allowed, subject of course to overall state control, if it is found to be in the national interest. This pragmatic approach to the problem has meant the expansion of foreign companies at a rate which was not contemplated under the original policy pronouncements. When the Industrial Policy Resolution of 1956 was formulated, the total capacities of the private oil refineries was about 4.3 million tons per year. Despite the declared policy of strengthening the relative position of our national oil industry, the private foreign sector has been allowed to expand their capacity to a level of 7.65 million tons as at present.

In the ultimate analysis, the success of the government's foreign capital policy in the petroleum sector will depend on the speed and efficiency with which the expansion of the national oil industry is achieved. As the domestic sources of oil supply increases, and as the public sector companies are in a position to offer effective competition to the foreign companies, the stage will be set for the successful implementation of regulatory measures.

As a general directive for policy fixation, it may be stated that foreign investments should be discouraged or restricted in those fields where there is a net cost to the Indian economy. On the other hand, if in certain sectors there is net benefit, our policy decision, on the basis of purely economic criteria, should be to encourage the inflow of foreign capital into these sectors. Needless to mention that in the formulation of national policy, a detailed evaluation of the costs and benefits of particular investment projects will have to undertaken.

A truly national policy towards foreign capital should aim at maximising the benefits of foreign investment projects and minimising their costs. The following suggestions need to be seriously considered in this respect. The first suggestion relates to the domestic absorption of benefits. The benefits that accrue to the Indian economy can be maximised by a process of increased domestic absorption of the fruits of technical progress and productivity in the foreign sectors. The accrual of benefits in the form of productivity and income increases can be absorbed into the domestic economy

either through income absorption or through the absorption of technical know-how.

The increase in output and income resulting from the investment of foreign capital is usually transferred to the investing countries, as a result of which the recipient countries are denied the benefits of such investments. The transfer of investment income means a 'leakage of benefits' or a reduction in the total national product. Subject to the proviso that a reasonable margin of profits should be allowed to be repatriated as an incentive condition for foreign investments, our national policy should aim at ensuring the retention of maximum income in the national economy. As H. W. Singer has pointed out, 'the main requirement of under-developed countries would seem to be to provide for some method of income absorption to ensure that the results of technical progress are retained in the under-developed countries in a manner analogous to what occurs in the industrialised countries.'[99]

To the extent to which the increase in output and income in the foreign sector is a result of 'external economies' provided by the Indian economy, such a retention of part of the profits has economic justification. Increased absorption of income must be tackled at three different levels. Firstly, absorption of income can be effected through reinvestments of profits. Foreign firms can be required to plough back part of their profits into the industry. Operationally, it can be achieved by putting a ceiling on profit transfers. Profits above the ceiling have to be necessarily reinvested in the industry. Reinvestment can also be stimulated by increasing the tax on distributed profits.[100]

Secondly, income absorption can take the form of absorption of profits by fiscal measures. Profits of foreign concerns can be absorbed in the Indian economy by fiscal measures such as taxation and compulsory savings in government bonds. Increased taxation has its own limitations. Taxation

99. H. W. Singer, 'The Distribution of Gains Between Investing and Borrowing Countries', *American Economic Review*, 40 (1950) May, Papers and Proceedings, 483.

100. United Nations, *Report of the United Nations Mission of Technical Assistance to Bolivia* (New York, 1951) 36.

above a point may become a serious deterrent to private foreign investments. However, there is sufficient room for an increase in governmental revenue through additional taxation of foreign income generated in India.

In the financial year 1953-4, the total tax revenue of the Government of India amounted to Rs. 420.3 crores.[101] In the same year, the revenue derived from taxation of foreign concerns in India came to about Rs. 20 crores.[102] This gives a percentage share of 4.8 per cent of the foreign private sector in the total tax revenues of the Government of India.

Table 64

REVENUE DERIVED FROM TAXATION OF FOREIGN CONCERNS

Years	*Rs. crores*
1951-52	21.34
1952-53	18.79
1953-54	20.00
1954-55	24.50
1955-56	19.35
1956-57	21.39

Source: Information laid on the table of Lok Sabha in reply to Unstarred Question No. 1108, 4 December 1957.

The absorption of income originating in the foreign sector in India through fiscal measures is, of course, of pivotal importance to India in her attempts to raise financial resources for her development plans. The state has a rightful claim to a portion of the income of foreign firms because the State has been an inducing instrument in the growth and expansion of a number of foreign industries in India. Particular mention should be made of the plantation industry. The history of the growth of these industries clearly show that but for the consistent help rendered by the state they would not have survived the stresses and strains which were experienced by these industries during continued industrial and commercial depressions. The absorption of a portion of the income generated in the foreign sector into the national exchequer for investment expenditures of the Plan is not only right but necessary. Foreign concerns could

101. *Report of the Taxation Enquiry Commission (1953-54)* II, 389-9.
102. Information laid on the table of the Lok Sabha in reply to Unstarred Question No. 1108, 4 December 1957.

also be required to invest part of their profits in government bonds. In the mobilisation of savings for the five year plans, the foreign firms should be required to play an increasing role.

The third method of income absorption is the absorption of rising productivity in real wages of the workers engaged in the foreign concerns in India. The increase in wages need not necessarily mean a reduction in the present rates of profits of the foreign concerns. It could as well be a wage increase which is tied to an increase in productivity in the foreign plant. After fixing minimum or fair wages to the workers, wages may be allowed to fluctuate above the minimum in relation to productivity and income. Part of the increase in income of workers may again be mopped up by the government through government bonds and small savings schemes.

The absorption of the benefits of foreign capital through greater assimilation of technical know-how and expertise is as important as the absorption of income. In a country like India, this assumes greater significance because without better technology and managerial experience the abundant natural and human resources cannot be industrially harnessed to the advantage of the starving millions.

It is generally admitted that technical knowledge and managerial skill can be better assimilated into the Indian economy if they are accompanied by the import of capital. However, the volume of benefits which Indian economy can derive will depend on the capacity of the Indian economy to inherit foreign technology. In other words, India's propensity to absorb foreign technology and our receptiveness to accommodate scientific norms and values in the womb of India's decadent and traditional socio-economic structure, all set the limiting factors. However, certain governmental policies and measures seem to be imperative. Firstly, provision should be made for the increased employment and training of Indian nationals in the foreign concerns. The pace of Indianisation of employment in the foreign sector having been very slow in the past, express directives have to be given and enforced in this direction in the future. The

appointment of foreign technicians and managers in foreign firms in India should be considered only as a short-term measure. They should be replaced by Indian nationals at the earliest possible date by training Indians on the job.

The absorption of income through the limitations on profit transfers, it should be noted, will itself act in the direction of minimising the cost of foreign investments. The absorption of profits means a reduction in profit transfers and consequently a reduction in the depletion of our national product and an easing of the balance of payments problem.

As has been proved in earlier chapters, the continued inflow of foreign capital is liable to create a serious foreign exchange problem in the future. The serious exchange gap during the first two years of the Second Plan could be bridged by a frantic effort to raise loans from foreign governments and international agencies. We have successfully raised the necessary external finance to fill the gap. But we have not solved the problem as such, but merely postponed it.

Planning is a continuous process. We view the five year plans as separate entities only for the sake of convenience. There is no sanctity for the five-year period either. Planning and development being a continuous process, we have to start solving the future foreign exchange problems right now.

Apart from the policy of restricting investment income transfers there is an area where the foreign exchange cost can be reduced, namely, the reorganisation of the foreign sector on export-import lines. This policy of reorganising the structure of the foreign sector is based on the theory that just as rupee resources are a function of domestic savings, foreign exchange resources are also a function of domestic savings. In other words, it is possible to raise foreign exchange resources 'domestically' in the sense that it can be mobilised by reorganising the export-import sector even at the cost of reduced domestic consumption.[103]

103. The Japanese experience shows how a country determined to achieve industrial growth can push forward development projects without any sizeable amount of foreign capital. Japan relied on domestic capital

It is a simple paradox, generally not well appreciated, that a policy of increasing the private foreign capital inflow into India should be a policy of disincentives to foreign capital rather than a policy of incentives. This paradox arises from the particular pattern of private foreign capital inflow into India. Capital inflow in the form of inward cash transfers, obviously, can be increased only by giving further incentives to foreign capital. But the predominant position of reinvested profits as a component of foreign capital inflow indicates that a policy of deterrents might give better results. A policy of disincentives will increase capital inflow by restricting or prohibiting repatriation and investment income transfers. Assuming (i) that the present rate of private capital inflow into India cannot be stepped up to any significant extent through further incentives, and (ii) that a policy of disincentives to private foreign capital will not indirectly affect the 'political' decisions of foreign creditor governments and international agencies, it can be shown that a policy of disincentives give the following better results in India.

In comparison to the present average annual net inflow of Rs. 20.8 crores the policy of disincentives will provide larger resources amounting to Rs. 24.5 crores per year. This is possible through (i) retaining the present rate of reinvestments to the tune of Rs. 14.7 crores per annum, (ii) diverting the Rs. 24.4 crores per year of investment income transfers, (iii) prohibiting the average annual repatriation of Rs. 11.7 crores, while losing (i) the present gross cash inflow of Rs. 4.7 crores and (ii) the investments in kind to the extent of Rs. 21.6 crores per year.

The efficacy of a policy of disincentives, however, is dependent on the two assumptions we have made earlier, namely, the stagnation in the rate of private foreign capital inflow and the absence of any repercussions on the availa-

and resources were diverted into export industries (particularly tea and silk) with the result that substantial foreign exchange resources were mobilised for the import of necessary capital equipment and raw-materials. —See T. Yamanaka, 'Japanese Small Industries During the Industrial Revolution', *Annals of the Hitotsubashi Academy*, October 1951, 33-5.

bility of public foreign capital. But these assumptions, in actual policy fixation, are not entirely valid. Firstly, it should be noted that, since the availability of public foreign capital, particularly from foreign governments, is more or less a function of politics or diplomacy, the government attempts to restrict private foreign capital may affect adversely the possibility of getting foreign aid from governments which are wedded to private enterprise economy. To the extent to which external aid is available from socialist countries, however, this consideration does not put a serious limitation. Secondly, the possibility that the rate of private capital inflow can be increased through greater incentives cannot be excluded. But Indian experience in the last ten years suggest that the prospects of further stepping up the rate of private capital inflow through a policy of incentives is not very bright. Even if we reject the assumption of complete stagnation in the rate of private capital inflow, the assumption of 'relative stagnation' in the rate of inflow or the relative inelasticity of private foreign capital inflow (in response to incentives) can still be sustained on the basis of Indian experience. It follows, therefore, that the government's policy of giving various incentives to private foreign capital can have any real meaning only in terms of the repercussions of such a policy on the availability of public foreign capital. The policy of incentives to the private foreign sector in India is, in effect, a policy of ensuring the inflow of public funds from foreign governments and international institutions which represent the interests of private enterprise.

A national policy towards private foreign capital should aim at maximising the benefits of foreign investments and minimising their costs. It should be remembered that an obstinate refusal to consider whatever benefits which a recipient country can acquire from foreign investments is as bad as an unconditional welcome to and exaltation of foreign capital in all its forms. An objective assessment of the role of foreign investments in the economic development of the Indian economy should, therefore, take into account both the benefits and costs involved.

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